**THE STATE AND THE INTERNATIONALISATION OF CAPITAL:
THE MEXICAN TERRITORIALITY OF GLOBAL FINANCE, 1982-2006**

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Abstract

The dissertation focuses on Mexican class relations, the role of the state and the spatial practices that reproduce finance in Mexico at different political scales. I situate my research within Marxist analysis of internationalisation of capital, state restructuring, and critical geography. The main argument of the thesis is that the spatiality of the Mexican state in constituting the globality of finance matters despite claims of the demise of the state and the 'end of geography.' In order to explore the intersection of finance, the territoriality of the state and class in the Mexican political economy, the analysis looks at three aspects. First, historical transformations of the state and economic policy are addressed to understand the centrality of finance in the Mexican economy, particularly in the import-substitution industrialisation and neoliberal restructuring periods, and the role of the Mexican state, and the power bloc in shaping the conditions for finance within Mexico. Second, the creation of the scales of governance of the Mexican state through the North American Free Trade Agreement, regional development and the national economy is focused upon to understand the ways in which internationalisation of capital is reproduced within the nation-state through the disciplinary effects of the national, local and regional scales of the Mexican state. Third, the thesis shows how Mexican monetary policy has become a main component driving derivative markets. These policies and financial derivatives have a pivotal role in accelerating the pace of financial crises, fostering discipline over capitalist social relations in Mexico and creating new spaces of regulation for the Mexican state.

To my parents, Baldemar and Olga Leticia

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Table of Contents

Abstract		*iv*
Dedication		*v*
Acknowledgements		*vi*
List of Abbreviations		*vii*
List of Figures		*ix*
Chapter 1	Introduction: The Internationalisation of the Mexican Economy	1
Part 1	**Theoretical and Historical Positions**	22
Chapter 2	State, Power and Money: The End of Geography?	23
Chapter 3	The Development of the Mexican Financial System	89
Part 2	**Finance and the Restructuring of the Mexican State**	132
Chapter 4	Finance, the 'Internal Bourgeoisie', and Transformations in the Mexican State	133
Chapter 5	Finance and the Consolidation of State Restructuring in Mexico	177
Part 3	**Finance and the Scale of the Mexican State**	220
Chapter 6	The Politics of Scale and the Territorial Reproduction of Capital	221
Chapter 7	Finance and the Rescaling of the Mexican State	251
Part 4	**Financial Innovations and the Mexican State**	293
Chapter 8	Derivatives and the Discipline of Capitalism	294
Chapter 9	The Mexican Nationality of Global Financial Markets	321
Part 5	**Conclusion**	367
Chapter 10	State Policy, Financial Discipline and Democracy	368
Bibliography		388

List of Abbreviations

ABM	Asociación de Bancos de México-Association of Mexican Banks
BANCOMEXT	Banco de Comercio Exterior-Foreign Trade Bank
BANXICO	Banco de México-Bank of Mexico
Cetes	Certificados de la Tesorería- Treasury Certificates
CCE	Consejo Coordinador Empresarial- Business Coordinating Council
CONSAR	Comisión Nacional del Sistema de Ahorro para el Retiro Nacional-Commission of the Retirement Saving System
COPARMEX	Confederación Patronal de la Repúblic Mexicana-Confederation of Employers of the Mexican Republic
CNBV	Comisión Nacional de Bolsas de Valores-National Commission of Banking and Securities
CNC	Confederación Nacional Campesina-National Confederation of Peasants
CNOP	Confederación Nacional de Organizaciones Populares-National Confederation of People's Social Movements
CROM	Confederación Regional Obrera Mexicana- Regional Confederation of Workers of Mexico
CTM	Confederación de Trabajadores Mexicanos-National Confederation of Workers
FICORCA	Fideicomiso de Cobertura de Riesgo Cambiario- Foreign Exchange Risk Coverage Trust Fund
FOBAPROA	Fondo de Protección al Ahorro-Fund for the Protection of Savings
GATT	General Agreement on Tariffs and Trade
IPAB	Instituto para el Ahorro Bancario-Institute for Banking Savings

NAFINSA	Nacional Financiera
NAFTA	North American Free Trade Agreement
PAN	Partido Acción Nacional-National Action Party
PECE	Pacto de Estabilidad y Crecimiento Económico-Pacto of Stability and Economic Growth
PEMEX	Petróleos Mexicanos
PRD	Partido de la Revolución Democrática-Party of the Democratic Revolution
PSE	Pacto de Solidaridad Económica-Pact of Economic Solidarity
PRI	Partido Revolucionario Institucional-Institutional Revolutionary Party
PROCAPTE	Programa de Capitalización Temporal-Temporary Capitalisation Program
PRONASOL	Programa Nacional de Solidaridad-National Program of Solidarity
SAT	Sistema de Administración Tributaria- Revenue Collection Agency
SEDESOL	Secretaría de Desarrollo Social-Ministry of Social Development
SHCP	Secretaria de Hacienda y Crédito Público-Finance Ministry
SPP	Security and Prosperity Partnership
Tesobonos	Bonos del Tesoro-Treasury Bonds

List of Figures

Figure 1: Public Investment by Sector, 1938-69 (billions of pesos) 109

Figure 2: Employment by Sector (percentage) 114

Figure 3: Expansion of Mexican Private Banks, 1925-69 (millions of pesos) 116

Figure 4: Expansion of Mexican Private Banks, 1970-82 (billions of pesos) 120

Figure 5: Government Income from Credit and Other Financial Instruments (millions of pesos) 123

Figure 6: Inflation Rate, 1969-82 127

Figure 7: Banks Privatised by the Mexican Government, 1991-92 155

Figure 8: Mexico's Brady bonds 1989-90 (millions of dollars) 158

Figure 9: Annual Variation of the Mexican GDP and Financial Activities 159

Figure 10: BANXICO's Intervention through the *Corto* 190

Figure 11: Interbank Overnight Rate 192

Figure 12: Inflation target and Inflation rate 193

Figure 13: Minimum wages, 1994-2005 (prices of 1994) 201

Figure 14: Allocation of Government Budget Expenditures (millions o pesos) 202

Figure 15: Labour Productivity in the Mexican Manufacturing Sector (hours per worker index) 205

Figure 16: Mexico's GDP (annual percentage) 206

Figure 17: Interest Rate Differentials 330

Figure 18: CEMEX's Financial Statement (millions of dollars) 347

Figure 19: Mexico's Public Debt (percentage of GDP) 353

Chapter 1

The Internationalisation of the Mexican Economy

By the early 1990s, Mexico was often evoked as a triumphant illustration of the economic benefits of liberalisation policies. The turmoil of the 'lost decade,' as the 1980s came to be known, was a distant memory. With inflation falling, the Mexican economy was showing tremendous promise. Foreign investors were placing vast sums of money into the country, and the central bank was accumulating billions in foreign reserves. These developments were accompanied by proposals to reduce trade barriers with the United States through the North American Free Trade Agreement (NAFTA). NAFTA eventually took effect in 1994, and the 'Mexican miracle' appeared to be well underway as part of a new continental market.

Mexico's economic success was attributed to the implementation of market-oriented policies, which had begun to gather sway over public policies following the 1982 debt crisis. The newly adopted approach had emphasised that the state's withdrawal from economic affairs and the opening of commodity and financial markets would enhance efficiency and raise the growth potential of developing countries. The rationale behind this orientation was that markets were quite naturally more adept at allocating resources than governments.

Less than twelve months after NAFTA took effect, the Mexican economy began to stagnate. By December 22, 1994, the Mexican government was forced to devalue the currency, and a financial crisis ensued. Monetary measures to stem soaring inflation brought on a severe recession, and the theoretical claims of unfettered trade and financial

liberalisation were cast into doubt. The notion that Mexico was on the right track, at least in terms of policy outcomes, became less and less plausible.

The promoters of financial intensification and market deregulation needed to realign their perspective. John Williamson, for example, the former Chief Economist for the World Bank's South Asia region and senior fellow at the Institute for International Economics, argued that governments ought to play a more active role in maintaining the institutional infrastructure of a market economy, providing public goods, promoting the diffusion of technological information and encouraging industrial clusters.[1] His statement clearly suggested revamping the state's role and implied a re-examination of the nature of markets. Although not entirely contradictory, it did represent a considerable reversal of policy advice. After all, Williamson had been a leading advocate of 'pure' structural adjustment policies, and it was he who had coined the phrase "Washington Consensus."[2] This position was reinforced when the 1994 peso crisis was followed by a period of economic recovery from 1997 onwards, coupled with the Mexican state's economic policies of austerity. As a result, the economic upturn was used to justify the new argument that recommended state intervention in order to deal with the 'negative' externalities of the market.

Through the 1990s, Mexico continued along the deregulatory path. With respect to the financial sector, this meant a series of privatisation measures and the sale of several

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[1] John Williamson, "Overview: An Agenda for Restarting Growth and Reform," in Pedro-Pablo Kuczynski and John Williamson (eds.), *After the Washington Consensus: Restarting Growth and Reform in Latin America*, Washington: Institute for International Economics, 2003, pp. 11-2.

[2] The Washington Consensus is a phrase initially coined in 1987-88 by John Williamson to describe a relatively specific set of economic policy prescriptions to expand the role of market forces and constrain the role of the state. This set of policies was promoted for debtor countries by Washington-based institutions such as the International Monetary Fund, World Bank and U.S. Treasury Department.

major national private banks to foreign corporations.[3] The sale of financial institutions is of particular significance in that the process also prompted a heated debate about the pros and cons of internationalising Mexico's financial sector.

The political left, notably the Democratic Revolution Party (Partido de la Revolución Democrática, or PRD), condemned the process. With a fundamental economic pillar now in foreign hands, the perception was that the country's economy would cease to be Mexican.[4] The Institutional Revolutionary Party (Partido Revolucionario Institucional, or PRI) had a different view.[5] Advocates of economic restructuring within the party supported the opening of the financial system to foreign banks. Populist factions within the PRI criticised the sale of Mexican banks to foreigners based on arguments regarding the loss of sovereignty. Despite opposition within the party, the PRI, particularly the party's representatives in Congress, supported the legislation that allowed foreign corporations to purchase Mexican private banks.[6]

As the process of mergers and acquisitions of Mexican banks consolidated, former President Vicente Fox (2000-06) argued that financial liberalisation was integral to the

[3] The more notable cases are Citigroup's purchase of Banamex, Mexico's first commercial bank, and the sale of Bancomer, the second-largest Mexican bank, to the Spanish Banco Bilbao Vizcaya.

[4] For instance, Ricardo Pascoe, a senior representative from the PRD argued that "the economy has lost its national meaning." Craig Torres, "Foreign Takeovers Are Causing Upheaval in Mexican Businesses," *Wall Street Journal,* 30 September 1997. The Zapatista Front of National Liberation (Frente Zapatista de Liberación Nacional or FZLN) also opposed the sale of banks. "All barriers to the entrance of international banks into Mexico have been eliminated," claimed the Zapatista Front in 1997. "The government uses the disaster of national banks (privatised) and its financial policy, to facilitate the arrival of the great international banks. In practice, there will no longer be Mexican banks. And so, once again, one of the fundamental sources of national wealth will be left in foreign hands." See: Frente Zapatista de Liberación Nacional, *Political Declaration of Zapatista Front of National Liberation with Respect to FOBAPROA*, Selva Lacandona, 10 June 1998.

[5] The position of the PRI, particularly in the Congress, was one of support to the Executive branch initiative to allow the entry of foreign banks into the Mexican economy.

[6] Ana María Rosas Peña, "Un Sistema Financiero Trunco," *La Jornada*, 13 September 2004.

country's development, and praised the entry of foreign banks into the Mexican economy. In a 2001 speech to the Association of International Financial Institutions, Fox stated that the "international financial institutions are fundamental to the process of internationalisation of our country and its financial system."[7]

Although these views clearly differ, they share an analogous conception of internationalisation. The increased participation of international corporations in the Mexican banking system following the 1994 peso crisis is interpreted as an external development that has transformed the Mexican economy. This, however, is a conception that is fraught with inconsistencies.

First, it assumes that the Mexican economy, particularly the financial sector, was without an international dimension prior to 1994. However, this is false, as Mexico was clearly already inserted into the international economy. Mexico had been under pressure to secure the value of the peso used in international transactions for over a decade. This was evident during both the 1982 debt crisis, the policies of structural adjustment, debt repayment, the 1994 peso crisis, and the bailing out of bankrupt banks that followed each crisis. The different phases of internationalisation of the Mexican economy need to be identified and analysed with respect to Mexico's internal pressures of political regulation and capital territorialisation.

Second, the continued existence of a national Mexican currency, monetary policy, taxation and expenditure policies, a legal system regulating competition within the country, and immigration controls, all suggest that the primacy of the Mexican nation-

[7] *Presidencia de la República,* "Discurso de Vicente Fox la Asociación de Instituciones Financieras Internacionales," Mexico, 8 November 2001.

state has not been wholly sacrificed. The real conceptual and political questions are: how has the Mexican state been reorganised through a restructuring of the state apparatus and policy changes, and how has this altered political relations internal to Mexico and within the international state system?

Third, the image of power associated with foreign companies and the notion that they prevail over the territoriality of the Mexican state becomes less sustainable when financial markets are considered. On the one hand, states establish monetary and financial policies and the political conditions of existence of firms and finance. On the other hand, the nationality of legal ownership – whether a company is national or foreign – becomes more problematic to define because of international financial innovations. For instance, a sophisticated financial instrument used to take advantage of regulatory differences might designate an off-shore Mexican firm to be regarded as a foreign company, even though all the work is done in Mexico. Correspondingly, the assets this company buys – Mexican government debt, for example – are also recorded as foreign investment in Mexico. However, the recipients of the profits derived from these purchased government bonds could, in fact, be Mexican nationals rather than a foreign investment. Internationalisation, therefore, takes place as a result of specific paper transactions not recorded by actual place of residence. On all these counts, the relationship between financial internationalisation and the political form of the state has to be considered historically contingent, rather than the result of the prevalence of international corporations and economic liberalisation over state policies and the national economy.

Neoliberalism and Economic Rationalism

The aforementioned conceptions of economic internationalisation have taken place in a context of neoliberal restructuring. This process has often been defined as a discursive transformation carried out by international financial institutions that promote free trade, the opening markets and the retreat of the state.[8] While these issues are important dimensions of neoliberalism, its conceptualisation cannot be described merely as a change of ideas or as the declining power of the state. The limitations of this notion of neoliberalism can be illustrated in the Mexican case. Alternative discourses to neoliberalism have been proposed by several social movements, and the PRD, the Mexican left-wing party, has strengthened its position in the Chamber of Deputies and several municipal and state governments.[9] Still, neoliberal policies pervade the country and continue to be implemented by representatives from all parties across different levels of government. These circumstances, therefore, require a broader understanding of neoliberalism as a system of power and a political project that operates through the nation-state to subject all social relations to market discipline regardless of the dynamics of partisan politics and political discourse.

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[8] See: Naum Minsuburg, "Transnacionalización, Crisis y Papel del Fondo Monetario Internacional y del Banco Mundial," en Atilio Boron, et al., (eds.), *Tiempos Violentos; Neoliberalismo, Globalización y Desigualdad en América Latina,* Buenos Aires: CLACSO, 1999; EZLN, *Segunda Parte de la Sexta Declaración de la Selva Lacandona, Los Zapatistas Explican cómo Ven el Mundo y México*, Selva Lacandona, 30 June 2005.

[9] For instance, several unions and social organisations gathered in Mexico City by the end of January 2007 to defend the right to food, a living wage and employment security in the context of rising corn prices. Here, unions and peasant organisations signed the *Zocalo* declaration, in which they criticised the government's economic model, arguing that the current economic policies only generate more unemployment, lower wages and the loss of food self-sufficiency. Most significantly, the declaration calls for the "democratisation of the economy," that is, the inclusion of citizens in the economic decision-making process.

In the current context of neoliberal restructuring and internationalisation of the Mexican economy, the politics of money are either seen as a technical matter or as the power of capital mobility over the state. Explanations of the particular processes through which markets work are often left to economic rationalism. Economic rationalism refers to those mainstream views that see the economy as composed by individualistic rational expectations.[10] The approach suggests that these expectations are better coordinated through the market than by the intervention of the state. In general, the functioning of the market and rational expectations are considered as neutral processes that operate in a social and political vacuum. Economic rationalism has been fundamental in the formulation of investment decisions and state policies that have driven the process of neoliberal restructuring. This can be seen mainly in financial investment and economic policy.

In the case of financial investment decisions, the pricing of assets is crucial in modern finance. Pricing models are based on the assumption that individual investors have rational expectations when selecting an asset. Consequently, the demand and supply of a given financial asset determine the asset's price. For instance, in the Capital Asset Pricing Model (CAPM), all individuals should hold the market portfolio levered up or down according to risk tolerance.[11] Such calculation remains central in determining risk and return in shares. According to this model, a person with low risk tolerance will have most of her money in the risk free security (a government bond, for example), while a

[10] See: John Carroll and Robert Manne, *Shutdown: The Failure of Economic Rationalism and How to Rescue Australia*, Melbourne: Text Publishing Company, 1992.
[11] Thomas McInish, *Capital Markets*, Massachusetts: Blackwell, 2000, p. 125.

person with high risk tolerance will invest in high return portfolio at a higher risk. Likewise, the Black-Scholes model identifies that the fair market value of financial instruments such as call options can be calculated based on the difference between the expected benefit from acquiring a stock outright and the present value of paying the exercise price on the expiration day. From this mathematical calculation of price, investors are expected to rationally select their assets. While these models have been superseded by more complex mathematical calculations, most of the techniques employed in price options and other financial instruments are rooted in the CAPM and Black-Scholes models.[12] The economic rationalist explanation of financial markets assumes, as mentioned, that money is a neutral mechanism of exchange and that investment decisions in this market occur apart from the rest of the economy and the nation-state. For this reason, this view advocates market liberalisation and economic opening in order to expand the myriad of investment options, facilitating the role of the market in coordinating expectations.

Economic rationalism has also permeated policy-making through neo-monetarism. In this view, inflation is the only macroeconomic problem demanding a policy solution. Neo-monetarism emerged when monetarism came under attack during

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[12] Indeed, economic rationalism has also included the possibility of irrational behaviour through behavioural finance. Behavioural economics studies common biases, irrational investment behaviours, and decision-trap situations that produce suboptimal outcomes for investors under conditions of uncertainty. In other words, this branch of economics analyses what investors actually do in a given set of circumstances versus what theory prescribes in order to remove biases from investment choice and exploit the bad choices of others to maximize gains (See: Robert Shiller, *Irrational Exuberance*, Princeton: Princeton University Press, 2000; Andrei Shleifer, *Inefficient Markets: An Introduction to Behavioral Finance*, Oxford: Oxford University Press, 1999). Like other economic rationalist views and models, behavioural economics' goal is to achieve rational and optimal investment decisions in financial markets despite its accounts for irrationality. While behavioural economics is becoming an important aspect of economic analysis, its role is still limited in mathematical pricing of assets in financial markets.

the 1980s. The attempt to control the money supply by targeting US reserves rather than the federal funds' rate in the late 1970s and early 1980s not only led to more volatility in interest rates, but also failed to deliver monetary stability.[13] As such, a new version of monetarism was formulated.

The two basic tenets of neo-monetarism are the natural rate hypothesis and the rational expectations hypothesis. The natural rate hypothesis implies that demand management is useless, since unemployment cannot be lowered permanently below some relatively high and stable 'natural rate' through government spending. The rational expectations hypothesis suggests that if people believe that monetary growth is slowing down, then they will lower their selling prices and lower their wage demands. As a result, this perspective argues, inflationary expectations, hence inflation itself, can be rapidly reduced without a prolonged period of unemployment, and tax cuts will increase savings, investment and productivity instantaneously.[14] The role of the state is limited to provide the conditions to create rational expectations of low inflation among market actors while the state's intervention to increase employment is restricted by the 'natural rate' of unemployment.[15]

The interplay of economic rationalism and neoliberal restructuring can be seen in the Mexican debt crisis of 1982. Prior to the crisis, bank lenders took the losses that arose from bad investment decisions. During the 1982 debt crisis, the private sector and international financial institutions considered international bank syndicates' investment in

[13] James W. Dean, "The Rise and Fall of Monetarism," *Financial Analysts Journal*, 1985, p. 73.
[14] Ibid., pp. 74-5.
[15] Alfredo Saad-Filho and Lecio Morais, "Neomonetarismo Tropical: A Experiencia Brasileira nos Anos Noventa," *Revista de Economia Política*, 1: 22, 2002, pp. 4-5.

Mexico to be the result of investors' rational decisions. It was argued that the negative outcome of the debt crisis of 1982 was due to excessive government intervention. The Mexican economy took the costs of debt repayment *via* state power through monetary policies of low inflation, low wages and economic austerity.[16] This, in turn, raises issues of why and how the cost of monetary obligations have been burdened by the Mexican working classes, and why the politics of money, which are enforced by the Mexican nation-state, are important in the implementation of neoliberalism in Mexico in the context of greater economic internationalisation and financial mobility.

The Mexican State and the Internationalisation of Capital

The study of the Mexican state in the context of financial innovation and neoliberalism must attempt to reconcile the internationalisation of capital and the territoriality of the state. The overarching question is: how does the nationality of the Mexican state and its economy coexist with the globality of financial markets? This apparent analytical paradox revolves around three core issues: *The territoriality of the state, global finance as a social relation, and the expression of the relationship between the state and global finance in national class relations.*

First, the concept of territoriality of the state has been the focus of an intense debate in Mexico and across the social sciences in general, particularly because of the increasing mobility of financial capital since the 1970s. This has resulted in the commonly-held supposition that nationality and state territoriality do not matter as the nation-state has been 'hollowed out' by financial markets, international financial

[16] David Harvey, *Spaces of Global Capitalism: Towards a Theory of Uneven Development*, New York: Verso, 2006, pp. 23-4.

institutions or US dominance in the world affairs. Many approaches have then focused their research on whether or not the nation-state remains in control of global financial markets and their specific economies. This line of thinking suggests that the state and capital are competing entities with divergent interests, and that each functions independently of the other. As Dick Bryan notes, in this line of thinking, "there is no perceived contradiction within the internationalisation of capital: only between capital and the nation."[17] The lack of consideration for this contradiction occurs because conflictual relations in society tend to be reduced to arguments that focus on the increase of the power of capital and the resulting decline of the state, and hence the diminishing importance of its territoriality. In this respect, Blanca Ramírez Velázquez argues that discussions asserting the demise of the nation-state, the disembedding of social relations from the national territory and the antagonism between international capital and the state "tend to neutralise the power relations that exist behind the spatial expansion of global capitalism."[18] These arguments remove the social agency that occurs within global capitalism through concrete and territorially embedded localities.[19] *For this reason, it remains important to understand the internationalisation of capital as a historically distinct project shaped by the state and contradictory and territorially-grounded*

[17] Richard Bryan, "The State and the Internationalisation of Capital: An Approach to Analysis," *Journal of Contemporary Asia*, 17: 3, 1987, p. 256.
[18] Blanca Rebeca Ramírez Velázquez, *Modernidad, Posmodernidad, Globalización y Territorio*, Mexico: UAM-Porrúa, 2003, p. 61.
[19] Ibid., pp. 62-3.

capitalist social relations rather than the "unfolding of inevitable capitalism or globalisation tendencies."[20]

Second, in most writings of the Mexican economy, and general studies of recent economic transformations, money is interpreted either as a medium of exchange or as a mechanism that creates external financial bubbles at the global level which negatively affects national economic transactions. Yet, recent international financial crises show that money transactions not only alter an economy's performance, but also transform the class relations of a social formation. This shows that money can neither be reduced to a neutral instrument for economic transactions nor considered as an obstacle to capitalist accumulation. Rather, national money is central disciplinary mechanism internal to the international expansion of capital. This disciplinary aspect, in turn, represents the form that social relations take within money, and this aspect mediates the relationship between local investment, national accumulation and international discipline and competition. For this reason, it remains important to account for the role of money in accumulation, and its relationship to national currencies and state policies. *The study of money as a social and political relation is integral, therefore, to examining power relations in political science.*

Third, while it is important to recognise the way in which global capitalism and the state constitute each other, this process does not occur in a social and political vacuum. The social power of money and finance does not have a uniform effect on a unified and passive nation-state, including its internal social and institutional structures. Rather, historically-specific and contingent social relations lie underneath the formation

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[20] Philip McMichael, "Revisiting the Question of Transnational State: A Comment on William Robinson's Social Theory and Globalisation," *Theory and Society,* 30, 2001, p. 202.

of the capitalist state and international accumulation. Within the nation-state, the shifting balance of forces among social subjects is crucial to understanding how global capitalism is concretised within the nation-state and how they determine and contest the ways in which market-oriented policies are implemented. *By looking at the class configuration within a social formation, one can understand how capitalist social relations, which exist internationally, are reproduced through the state. In this way, the state is not considered as "a monolithic bloc, but a strategic field of class struggle."*[21] The analysis of the class relations within the nation-state sheds light on the ways in which the internal dynamics of a country influence state policies, particularly those related to the politics of money.

By considering the contingent and historical social relations within the nation-state, one can analyse the recent implementation of neoliberalism not only as policies and/or ideologies that eliminate obstacles to the operation of free markets and build adequate institutions supporting the market. *Rather, neoliberal policies can be seen as a political strategy to reformulate the relations between nation-states and global accumulation, and between the state and society.*[22]

A critical study of the spatial dimension of the state and accumulation then allows for an understanding of states and markets as two contradictory moments of the same capitalist social relations that have a concrete existence rather than as opposing and abstract forces within capitalism. Such an approach to the study of money emphasises how money is a political and social relation and how its financial form has also become a

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[21] Nicos Poulantzas, *Classes in Contemporary Capitalism*, London: New Left Books, 1974, p. 138.
[22] Ruth Felder and Hepzibah Muñoz Martínez, "Market Reforms, Social Discipline and Crisis in Mexico and Argentina," *Paper presented at the conference Hegemonic Transitions and the State*, Vancouver, 23-224 February 2007, p. 23.

disciplinary form of power. This brings money and finance, which are often described in economistic terms, back into politics. Such an understanding allows for the problematisation of the so-called distinction between the political and the economic sphere by looking at the relationship between the state and money. A class approach to the state and the power bloc offers an analysis of domestic processes occurring within the nation-state that maintain and simultaneously contest the expansion of global finance and social relations of production within its own national territory.

By considering these three aspects – namely, the territoriality of the state and global accumulation, money and finance as social discipline, and the class relations within the state – the central proposition of this thesis is that the territoriality of the Mexican nation-state has constituted the globality of accumulation of capital, and the class struggle reflected within the Mexican state has determined the ways in which the economy has been articulated to the process of capital internationalisation through finance.

Critical Political Economy, Theory, and History

This dissertation is a theoretical and empirical examination of key developments in the Mexican state and the financial system since the 1980s. It seeks to explore theoretical and practical questions within political science, and more specifically within the field of international political economy. Within this field, analyses often proceed from the level of the nation-state as a unit of analysis, and explanations are made at a systemic global level.[23] For instance, world-systems theory sees social change as originating from the historical capitalist system that operates at the system level to

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[23]See: Philip McMichael. "Incorporated Comparison within a World-Historical Perspective: An Alternative Comparative Method," *American Sociological Review,* 55: 3, 1990.

explain specific divisions of labour and dynamics of the state.[24] Charles Tilly also uses the method of encompassing comparisons to explain variations among nation-states as the result of their relationship to the system as a whole.[25] The state, as a unit of analysis, reflects the transformations of the system. However, these two examples raise the methodological question of how we can study nation-states as units of analysis in the world economy when the contemporary nation-state has been transformed numerous times by processes of the world market and vice-versa.

Philip McMichael's method of incorporated comparison suggests a resolution to this dilemma. This method examines social phenomena from its internal dynamics, particularly social forces within capitalism, and sees the social world as processes of social relations that are not merely external and dualistic categorisations of the global/national.[26] Unit cases, namely nation-states, and the whole, the global economy, do not have internal properties autonomous from one another. As McMichael states:

> The whole, therefore, does not exist independent of its parts. Whether considering nation-states or a singular world system, neither whole nor parts are permanent categories or units of analysis. Generalization is historically contingent because the units of comparison are historically specified.[27]

This analysis incorporates time into the inquiry of social phenomena, so "the object of inquiry is historically distinct."[28] The critical investigation into the transformations of historical structures is the achievement of international political

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[24] McMichael. "Incorporated Comparison within a World-Historical Perspective, p. 390.
[25] Ibid., p. 388.
[26] Philip McMichael, "World-Systems Analysis, Globalization, and Incorporated Comparison," *Journal of World Systems Research*, 6: 3, 2000, p. 669.
[27] McMichael, "Incorporated Comparison within a World-Historical Perspective," p. 386.
[28] McMichael, "World-Systems Analysis, Globalization, and Incorporated Comparison," p. 672.

economy.[29] Robert Cox notes that a historical approach to social phenomena allows for an understanding of change within societies as transformations in the existing power relations rather than the result of institutional organisation. This, in turn, discloses dynamics of inclusion and exclusion as a changing process.[30]

While the process of historicising remains clear in the method of incorporated comparison, the issue of space remains ambiguous. For this reason, it is useful to historicise the territory and territorialise history, as Nicos Poulantzas suggests. In this sense, Poulantzas argues that the state establishes the particular relationship between history and territory, between the spatial and temporal dimensions of capitalism:

> The capitalist state marks out the frontiers when it constitutes what is within it by homogenizing the before and the after of the content of this enclosure... National unity then becomes historicity of the territory and the territorialisation of a history.[31]

This historical theory does not presume a social structure, but views social structure and institutions as formed through specific historical and spatial relations. There is no *a priori* conception of the composition and context of the units compared.[32] Nation-states and the global economy are mutually conditioning moments of a singular phenomenon and they are historically specified. This is consistent with McMichael's proposals for the comparative method of political economy, to view nation-states as "partial institutions of a broader, singular, global economy."[33]

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[29]Robert W. Cox, *The Political Economy of a Plural World: Critical Reflections on Power, Morals, and Civilization*, London: Routledge, 2002, p. 79.
[30] Robert W. Cox, "On Thinking About the Future World Order," *World Politics*, 28: 2, 1976, p. 183.
[31] Nicos Poulantzas, "The Nation," in Neil Brenner, et al. (eds.), *State/Space: A Reader*, Oxford: Blackwell Publishers, 2003, p. 78.
[32] McMichael, "World-Systems Analysis, Globalization, and Incorporated Comparison," p. 671.
[33] McMichael, "Incorporated Comparison within a World-Historical Perspective," p. 390.

The research program of a method based on historicity is to reveal historical dominant social relations. As Cox suggests, "theory is always *for* someone and *for* some purpose. All theories have a perspective."[34] In the case of critical international political economy, its method of research does not take order as given, but rather it asks how it came about and looks for points of social transformation.[35]

In this way, the method of incorporated comparison and international political economy allows for a historical conception of the changes of capitalist social relations in Mexico and how these relations have expressed themselves through the disciplinary power of money, finance, and the territoriality of the state and *vice versa*. As well, the Mexican state can be seen as having a historical relationship with global capitalism, where capital and the state are mutually constitutive of one another.

This is done by examining two periods of the Mexican class configuration and its spatial manifestations in the economy and the nation-state. First, the thesis studies the Mexican economy, particularly the financial system, the forms of state intervention, and the class configuration prior to the 1982 debt crisis. Next, the Mexican financial sector between the years 1982 and 2006 is focused upon. This latter period witnessed two severe crises that altered the social configuration within Mexico and the way in which financial markets function worldwide. The debt crisis of 1982, on the one hand, brought about an economic recession and entailed a profound transformation of the Mexican state. This transformation manifested itself in the shift from policies oriented to accommodate class conflict towards market policies of economic restructuring and

[34] Robert W. Cox, *Approaches to World Order*, Cambridge: Cambridge University Press, 1996, p. 87.
[35] Cox, *Approaches to World Order*, p. 95.

further capital's empowerment. The peso crisis of 1994 changed the functioning of the state's monetary policy and the overall national and international financial system. During this period, major transformations in the Mexican economy also took place, such as the issuing of new instruments of public debt and the emergence of financial engineering. Another significant change that came about during this time was Mexico's participation in NAFTA, which has altered the structures of governance in Mexico and throughout North America.[36]

Outline of the Thesis

In the next chapter, I present several theoretical positions on money, capital internationalisation, and state power. The chapter outlines economic rationalism, the neo-Weberian international political economy, and Marxist approaches to internationalisation, finance, and the state. This chapter also locates the argument of the dissertation in response to these approaches. Building on the work of Nicos Poulantzas, Greg Albo, Dick Bryan, David Harvey, and Leo Panitch on the internationalisation of

[36] In this dissertation, I use the following sources for the theoretical and historical research on Mexico. First, I have gathered historical data from the reports on monetary policy from the Mexican central bank from 1980 to 2006, the Mexican Executive branch's press releases and project reports, working papers elaborated by the Mexican Chamber of Deputies, the National Commission of Banking and Securities' press releases, documents of the Ministry of Economy and the Ministry of Finance. I have also employed documents and reports of international organisations, such as the Bank of International Settlements, the Inter-American Development Bank, and the Organisation of Economic Cooperation and Development. Second, I have used in this research international financial journals, Mexican newspapers, and working papers of international investment banks from 1980 to 2006. The gathering of information of more complex financial instruments and transactions that takes place in Mexico is particularly difficult. There is restricted access to the information of the National Commission of Banking and Securities, particularly the policies it implements and the financial transactions it monitors. Also, the data on the different kinds of derivatives linked to the Mexican peso and the over-the-counter derivatives operations in Mexico is very limited since these instruments are not included in the balance sheets of financial institutions. Despite these limitations, the understanding of the Mexican class configuration, financial development, and the transformations of the state through historical data provides a solid ground for the study of the relationship between the territoriality of the Mexican state and the internationalisation of capital.

capital and the state, I argue in this chapter that the state has constituted the global character of finance by creating and recreating the geographical differentials that drive global accumulation while reproducing class relation within its own social formation. In the third chapter, I provide an overview of the key historical developments of the Mexican financial system, the transformations of the Mexican state and the ways in which these two phenomena have been explained in the Mexican literature. In this chapter, I argue that the role of finance in the Mexican economy, particularly in the import substitution industrialisation (ISI) period, is largely neglected in the literature. By contrast, this chapter looks at the ways in which the state's construction of a Mexican financial system was integral to the development and the demise of the ISI as well as the further internationalisation of the Mexican economy prior to the 1982 debt crisis.

The second part of the dissertation deals with issues of finance and the restructuring of the Mexican state, including its historical transformations. The fourth chapter looks closely to the ways in which state policies and internal class conflict have shaped the integration of the Mexican economy into international accumulation. This chapter focuses especially on the "internal bourgeoisie" and the integration of finance capital into the power bloc that emerged from the Mexican state's policies of privatisation and altering the balance of forces within the Mexican state. The fifth chapter discusses how the internationalisation of Mexican capital, fostered by the Mexican state, has also transformed the configuration of the state apparatus, particularly the central bank. These transformations have resulted in the isolation of economic decision-making from popular pressures and its subjection to further control from

financial speculators. In turn, this is reflected in the creation of policies that reduce social spending, put downward pressure on wages and subordinate workers' demands.

The third part of the dissertation explores issues of finance and the spatial dimensions of state governance to elaborate on the internalisation of market discipline in contemporary Mexico. Chapter Six challenges economic rationalist and neo-Weberian assumptions, which see the process of regionalisation as an inevitable consequence of globalisation. By contrast, this chapter draws from the work of David Harvey, Henri LeFebvre, Eric Swyngedouw, and Richard Howitt on the politics of scale in order to better understand the state as an expression of class relations, which is itself spatially and socially constituted. This approach sees the scales of state governance as manifestations of the strategies of social groups to extend or intensify their control over people and nature by creating social spatial regulations in which scale is actively produced. Chapter Seven discusses the shift in the balance of forces within Mexico and its manifestation in the rescaling of the Mexican state through the North American Free Trade Agreement and local scales of governance. This, I argue, led to the further removal of economic governance from democratic accountability, the internalisation of the international norms of competition at different scales, and the internationalisation of Mexican class relations in global financial markets.

The fourth part of this study addresses current theoretical and empirical issues revolving around financial innovation, particularly financial derivatives, in the Mexican economy. Chapter Eight offers an alternative approach to finance and money, emphasising its political relations. In contrast to views that regard money as a store of

value and finance as an external mechanism that obstructs accumulation, this chapter discusses money as a social relation and finance as a disciplinary mechanism of capitalist social relations that assists accumulation. Chapter Nine focuses on the role of derivatives in the Mexican economy in light of the onset and aftermath of the peso crisis of 1994. I discuss how the state policies directed towards interest rates in Mexican public debt and exchange rate policies have become a main component driving derivative markets, predominantly currency and equity swaps. In this chapter, I show how the Mexican class structure and the restructuring of the Mexican state apparatus have provided the Mexican capitalist class with the conditions to secure their own reproduction by being crossed with other capitals in the form of finance.

In the last chapter, I survey the arguments presented in the thesis and analyse some of the prospects for Mexican development and democracy in light of the arguments of the dissertation. It deals specifically with state policy and proposes alternatives to current neoliberalism in order to politicise and democratise issues of economic policy-making.

Part 1 Theoretical and Historical Positions

Chapter 2

State, Power, and Money: The End of Geography?

In the aftermath of the Mexican peso crisis of 1994, many Mexican corporations and international financial institutions expressed their disappointment with the economic liberalisation process taking place in emerging economies. It was assumed that economic liberalisation provided the Mexican economy with further advantages since markets rewarded this country with capital inflows and provided macro-economic stability. Private sector and international financial institutions claimed that these anticipated outcomes of economic liberalisation were never realised due to weak supervisory institutions in emerging market states.[1] Moreover, some international institutions' and analysts' contention went further in questioning the capacities of governments to facilitate and manage the operation of financial markets. They suggested that financial markets had eroded the importance of the state, eluded territoriality, and diminished the state's capacity to conduct economic policy. These interpretations also tended to reduce the process of internationalisation to dichotomous conceptions of the fixity of the state versus the mobility of financial markets.

Both of these views leave several questions unanswered. Why does monetary policy, as well as territorially-defined currencies and interest rates, remain pivotal to the functioning of the financial system? What role does the state play in furthering internationalisation and financial expansion? If the state is powerless to its geography in the *loci* of global markets, why do nation-states continue to be the centre of economic

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[1] See Paul Krugman, "Dutch Tulips and Emerging Markets," *Foreign Affairs*, 74: 4, 1995, p. 28; Ricardo Ffrench Davis, *Reforming the Reforms in Latin America,* New York: St. Martin´s Press, 2000, p. 19.

intervention, particularly by sustaining the value of their currencies and as lenders-of-last resort? This chapter argues that explanations of financial markets, the state, and economic internationalisation often take for granted the dualistic opposition between the territorial character of the state and the globality of capital, leaving unexamined the ways in which nation-states constitute international accumulation. Such an understanding conceals the ways in which the state is an aspect of capitalist social relations and how, to some extent, its power lies in its ability to constitute and reproduce capital-labour relations within its boundaries. This chapter also shows that the internationalisation of capital, which has been clearly intensified by financial markets, does not eradicate national distinctions. On the contrary, internationalisation plays on the differences produced by the nation-state.

First, the chapter presents the approach of economic rationalism to finance and the state. Second, the critique of economic rationalism by neo-Weberian theory is discussed. This appraisal has emerged as the dominant means to explain financial liberalisation in Latin America as a result of the disenchantment with the liberalisation policies that have been applied in Mexico and elsewhere.[2] Third, the chapter analyses the international political economy (IPE) and Marxist schools' assessments of this new orthodoxy as well as their focus on the issue of institutional power and exploitation in relation to finance and the internationalisation of capital and the state. Fourth, I offer a Marxist interpretation of the circuit of capital and its relation to money, class struggle, and the spatial dimension of the internationalisation of capital and the role of the state in this

[2] See: Leo Panitch, "The State in a Changing World: Social-Democratizing Global Capitalism," *Monthly Review*, 3: 5, 1998.

process. Fifth, the relationship between the state and finance in the process of capital accumulation at the international scale is examined. Sixth, the chapter discusses how the state and policies of money management have been reorganised in the process of internationalisation of capital as the result of the class configuration of the power bloc, particularly that of the internal bourgeoisie.

Economic Rationalism, Capital Markets, and the State: The End of Geography?

The policy success of Mexico's economic restructuring in the late 1980s was attributed to the set of market-based policies that were implemented after the debt crisis of the 1980s that occurred across Latin America. The primacy of the market in this economic orientation replaced the import substitution industrialisation model (ISI) that had prevailed in Latin America from the 1940s on. Influenced by the work of John Maynard Keynes and Raúl Prebisch, the ISI model represented a set of policies that attempted to promote domestic industrialisation *via* import barriers in order to bolster domestic industry and improve the terms of trade between Latin American countries and their European and North American counterparts.[3] The model relied on active state involvement to guide the expansion of the industrial sector. In addition to taxing imports and subsidising domestic industry as well as agriculture, the model also provided support

[3] It is important to note that Latin American structural policies based on Prebisch's work were not identical to the Keynesian paradigm of industrialised countries. The latter focused on the securing of the aggregate volume of output corresponding to full employment rather than the promotion of activity within particular economic sectors, as was the case of the ISI policies. These policies were the result of the structuralist school's assumption that prices of Latin America's terms of trade of traditional exports such as raw materials were declining in relation to the prices of imports, principally manufactures. This in turn worsened the terms of trade for Latin American countries. See: Jonathan Barton, *A Political Geography of Latin America*, New York: Routledge, 1997, p. 25.

for labour and maintained a favourable position towards public enterprises. In this respect, Prebisch considered three purposes for financial and monetary policies:

> Avoiding a boom and bust cycle by controlling the violent ups-and-downs in agricultural prices and other foreign trade impacts on the economy; strengthening development and maintaining full employment; and stimulating the fastest possible rate of economic growth.[4]

Due to the combined influence of Keynesianism and Prebisch's structuralism on post-World War II policies in Latin American countries, speculative finance was considered a source of economic instability. Capital controls were seen as essential instruments to preserve the political independence of states faced with the consequences of a liberalised international trade regime within a system of fixed exchange rates.[5] As a result, policies of financial regulation, exchange controls, and restrictions on capital mobility were implemented.

In contrast, the new policy and theoretical orientations after the debt crisis stressed that the opening of markets, including financial markets, provide efficiency and growth potential to developing countries. Such propositions were derived from economic rationalism's emphasis on the allocative power of the market. The market has the ability to reduce the cost of capital by increasing liquidity and providing risk transfer capability and market information that assists in investment decision-making.[6]

Economic rationalist views of capital markets replaced the Keynesian emphasis on the negative substitution effects of idle money holdings that were not placed in

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[4] Edgar Dosman, "Markets and the State in the Evolution of the Prebisch Manifesto," *CEPAL Review*, 75, 2001, p. 89.

[5] Stella Maris Settimi, et al., "The Road from Orthodoxy Towards Structuralism: The Influence of John Maynard Keynes on the Economics of Raúl Prebisch," *Trabajos de la Asociación Argentina de Economía Política,* 1949, 2004, p. 27.

[6] Malcom Gillis, et al., *Economics of Development*, New York: W.W. Norton, 1996, pp. 109-11.

productive activities. This approach considered that Keynesian policies only promoted negative government intervention in financial markets.[7] These policies, it was argued, 'repressed' financial markets and curtailed the potential contributions of capital markets to economic growth.[8] These views on financial repression were articulated in the Shaw-McKinnon model, which incorporated money and finance in models relevant to developing countries.[9]

The Shaw-McKinnon model highlights the growth-reducing and distorting effects of financial repression. Financial repression is defined as a situation in which government and central bank regulations distort the operation of financial markets. These regulations include interest rate ceilings, the imposition of reserve requirements on commercial banks, and compulsory credit ceilings. The consequence, so the argument goes, is to reduce the flow of funds to the formal financial sector and distort the optimal allocation of resources, leading to lower levels of saving, investment, and growth.[10]

> Distortions of financial prices, including interest rates and foreign exchange rates, reduce the real rate of growth and the real size of the financial system relative to non-financial magnitudes. In all cases this strategy has stopped or gravely retarded the development process.[11]

In general, the economic rationalist assumptions of the Shaw-McKinnon model suggest that a liberalised financial system contributes to economic growth and

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[7] Guillermo Ortiz Martínez, *Capital Accumulation and Economic Growth: A Financial Perspective on Mexico*, London, Garland Publishing, 1984, p. 184.
[8] Pedro Aspe Armella, *Economic Transformation: The Mexican Way*, Cambridge: the MIT Press, 1993, pp. 3-4.
[9] Gillis, et al., *Economics of Development*, p. 110.
[10] Ronald McKinnon, *Money and Capital in Economic Development*, Washington: Brookings Institute, 1973, pp. 59-61; Edward Shaw, *Financial Deepening in Economic Development*, Oxford: Oxford University Press, 1973, pp. 81-7.
[11] Shaw, *Financial Deepening in Economic Development*, pp. 3-4.

development by mobilising savings and by allocating them efficiently across investment projects. The model is based on the assumption that high positive real interest rates encourage savings. This leads to more investment and economic growth based upon the classical assumption that prior saving is necessary for investment in the economy. Households and firms must accumulate money balances to finance the purchases of relatively expensive capital goods. Ronald McKinnon thus argues that there exists "basic complementarities between money and physical capital in fragmented economies."[12] The role of the liberalising state requires, for economic rationalism, the dismantling of financial repression: removing controls on interest rates, discontinuing the selective channelling of credit, and doing away with excessive banking regulations.

Models of this type subsequently influenced the financial policy reforms after the 1982 debt crisis in Mexico, and indeed, across Latin America. Government officials began to follow the path suggested by the new macro-economic framework to resolve problems arising from accelerating inflation, growing fiscal deficits, and mounting external debts. Previous 'populist policies' were blamed for the heavy government borrowing that induced capital flight.[13] Fiscal discipline and export-oriented and anti-inflationary monetary policies became the prevalent macro-economic mechanisms. The conventional wisdom then was that these policies provided the appropriate environment for combining macro-economic management for a stable economic environment with micro-economic incentives of the market. In other words, the adoption of the micro-

[12] McKinnon, *Money and Capital in Economic Development*, p. 59.

[13] For instance, Carlos Salinas de Gortari had declared, as Planning and Budget Minister under Mexican President Miguel de la Madrid (1982-1988), that the dangers of government deficits were made all too clear during the collapse of the Mexican economy in 1982. See: Steve Frazier, "Growth Spurts Imperils Mexican Austerity," *Wall Street Journal*, 6 May 1985.

economic criterion of market efficiency as determined by capital markets became an objective of macro-economic policy, creating a competitive market environment.[14] For economic rationalism, state intervention was, theoretically and practically, dispensable for economic development.

Economic rationalist micro-economic management places emphasis on individuals and firms managing their portfolio of assets optimally and shifting investment from savings to profitable capital markets. Optimisation is typically assessed through pricing model of financial assets that estimates the cost of capital and portfolio risk.[15] It is assumed that an economy can be modelled as a single consumer-producer – 'the representative agent.'[16] Individuals and firms are regarded as having rational and homogenous expectations. Both entities interact in a way that yields market equilibrium where all outcomes are optimally maximised against risk. In other words, the value of what a 'representative agent' wishes to sell "equals the value of what this agent wishes to buy."[17]

In the case of national economies as 'representative agents,' the idea of equilibrium at the international aggregate level refers to arbitrage. Arbitrage is the ability of market participants to buy in one market and sell in another to take advantage of price differentials. Arbitrage then can be seen when prices adjust to international market signals, and uniform rates of return establish themselves through purchasing power parity

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[14] Dick Bryan, "Global Accumulation and Accounting for National Economic Identity," *Review of Radical Political Economics*, 33: 1, 2001, pp. 62-3.
[15] Examples of these are the Capital Asset Pricing Model and the Black-Scholes model. Thomas McInish, *Capital Markets*, Massachusetts: Blackwell, 2000, p. 304.
[16] Steven Keen, *Debunking Economics*, Annandale: Pluto Press, 2001, p. 191.
[17] Ibid., p. 191.

(PPP) and interest rate equalisation. PPP refers to the convergence of local prices everywhere as an effect of the implementation of floating exchange rates. In other words, PPP claims that price parity holds for the price levels of two countries.[18] Interest rate equalisation, on the other hand, guarantees that the rate of return from holding risk-free financial assets would be the same, irrespective of the currency in which the assets are denominated. In other words, an investor can borrow in one currency, exchange the borrowing for a second currency, invest the proceeds, and, at the maturity of the investment, exchange the returns for the original currency and repay the loan, bringing international markets into equilibrium.[19]

For these reasons, advocates of financial deregulation have argued that market mechanisms optimise capital allocation in the economy. Accordingly, the efficiency of markets allows for the monetary sphere of the economy to maintain its endogenous stability. The deregulation of the financial system and the emergence of a global financial architecture have led several scholars to assert that worldwide integration of financial markets inevitably means the "end of geography."[20] According to this view, the fungible character of money and the developments in information technology allows finance to escape the confines of geography, and, more specifically, the nation-state. Richard O'Brien, for instance, argues that the globalisation of finance marks the demise of the nation-state and the creation of a single frictionless world market. O'Brien's

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[18] McInish, *Capital Markets*, pp. 241-2.
[19] Ibid., p. 257.
[20] See: Richard O'Brien, *Global Financial Integration: The End of Geography*, London: Pinter, 1992; Kenichi Ohmae, *The Borderless World: Power and Strategy in an Interdependent Economy*, New York: Harper, 1990; Howard Wachtel, *The Money Mandarins: The Making of Supranational Economic Order*, New York: Pantheon, 1986.

argument relies on the idea that recent developments in telecommunications have brought about the integration of financial markets around the world: "The choice of geographical location can be greatly widened… for example, back office functions may be in one location, sales forces may be spread widely across the marketplace, and the legal domicile of the firm may be elsewhere."[21] According to O'Brien, technology provides uniform availability of information between markets in a way that any place in the world is any more privileged than another as a market for financial products.[22]

While economic rationalism sees a homogenous space as a norm for finance to move freely, the nation-state is conceived as a distortion that needs to be overcome. In other words, the openness and vulnerability of the national economy to financial flows have led to the inability of the state to directly control money and rendered national economic policies ineffectual. Kenichi Ohame argues, "in terms of real flows of economic activity, nation-states have already lost their role as meaningful units of participation in the global economy of today's borderless world."[23] For this reason, the state can only be a facilitator of market outcomes, a more or less passive responder to the signals given by global financial markets. As a whole, economic rationalism contends that internationalisation of the economy is due to the mobility of finance, which is in itself a neutral mechanism of monetary gain. This process uniformly affects all societies and makes the state and its territoriality no longer relevant in the world economy.

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[21] O'Brien, *Global Financial Integration: The End of Geography,* p.1.
[22] Ibid., p. 8.
[23] Kenichi Ohmae, *The End of the Nation State: The Rise of Regional Economies*, New York: Free Press, 1995, p. 11.

Still, the parity of prices and interest rates, which economic rationalist approaches suggest signal the 'end of geography,' has not occurred since modern financial markets are driven by price differentials, particularly of currencies. These differences in prices are, in turn, constructed around nation-states. In other words, prices and currency values differ according to nationality, as with the Mexican peso.[24] For this reason, the role of the nation-state has remained pivotal, not only in defining the nationality of a given currency, but also in providing territorially-bounded guarantees and incentives for financial markets, particularly with respect to the worthiness of its national currency.

In other words, and contrary to financial theories based on notions of equilibrium and the 'end of geography,' actual market outcomes have not reflected predicted outcomes of market efficiency, perfect capital mobility, and seamless global markets. This is particularly evident in the case of exchange rates. Although economic rationalism has predicted that floating exchange rates would cause local prices to be the same everywhere, exchange rates have not adhered to the law of one price.[25] Transactions and disequilibria in capital markets have not led to arbitrage, but rather to the asymmetrical distribution of wealth which has very concrete localised effects within territorial states. Prices still fluctuate according to specific location and markets, particularly in relation to

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[24] See: Bryan, "Global Accumulation and Accounting for National Economic Identity."

[25] There have been many studies that demonstrate that purchasing power parity has not taken place. Still, assumptions of price uniformity in goods and interest rates remain central in predominant models of assets pricing in financial markets. See: Michael Panos, et al., "Purchasing Power Parity Yet Again: Evidence from Spatially Separated Commodity Markets," *Journal of International Money and Finance*, 13, 1994; Razzaque Bhatti and Imad Mossa, "A New Approach to Testing Ex Ante Purchasing Power Parity," *Applied Economics Letters,* 1, 1994; Razzaque Bahti and Imad Mossa, "An Alternative Approach to Testing Uncovered Interest Parity," *Applied Economic Letter*, 2, 1995.

its exchange rate.[26] Spatial differences in the form of price divergence across countries, the nationality of currencies, and the role of the nation-states in maintaining the worthiness of their currencies are not reducible to mere distortions in the market.[27] Rather, they are the main components that allow exchange rate speculation, bond trading, and other financial transactions to occur. The processes that drive the internationalisation of finance are, therefore, dependent on the policies of the nation-state and its internal productive and regulatory structures.

Finance, Spaces of Flows, and Spaces of Places: The Rise of the New Orthodoxy

The anticipated benefits of free capital mobility and the 'end of geography' suggested by the policies of liberalisation have not taken place. The political and social effects of financial crisis over the past two decades in countries that have followed the 'end of geography' political agenda have made economic rationalism and its resulting policy positions difficult to sustain. It has not been easy to justify this logic to those who bear the financial costs of economic instability when a country or firm's short-term debt falls due and asset prices go down. For this reason, a new approach to economic internationalisation has been emerging, which recognises that global financial markets are not perfect and capital mobility may impede economic performance. Financialisation, according to this view, may negatively affect economic development, constrain the policy room of the nation-state, and have a differential impact on sectors of society.

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[26] Bryan, "Global Accumulation and Accounting for National Economic Identity," p. 60.
[27] Elmar Altvater and Birgit Mahnkopf, *Las Limitaciones de la Globalización. Economía, Ecología y Política de la Globalización*, Mexico: Siglo XXI, 2000, p. 30.

This neo-Weberian perspective has replaced the economic rationalist notion of equilibrium in financial markets with the concept of networks and flows.[28] These networks act as interconnected nodes, and their increased permeation into society is facilitated by advances in information technology. As a result, Manuel Castells argues that the pervasive use of networked communication media and network patterns characteristic of the high-tech sector has brought about a new form of organisation called informational capitalism.[29]

Within this framework, financial markets are seen as the result of the technological conditions under which the financial system operates. In other words, technology allows for instantaneous trading worldwide, the reduction of transaction costs, and the opening of new opportunities for investors.[30] Such technological developments allow for an increase in the speed of transactions between unrelated locations, allowing for the annihilation of space and compression of time.[31] In this respect, Castells argues that gains in different financial markets are greater than before.

> This is so not because of the nature of financial capital, the oldest form of capital in history, but because of the technological conditions in which it operates in informationalism – namely, its annihilation of space and time by electronic means and its technological and informational ability relentlessly to scan the entire planet for investment opportunities and to move from one option to another in matter of seconds...[32]

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[28] I refer to the neo-Weberian perspective as those approaches that show the same suppositions of Max Weber, whether the authors explicitly see themselves as Weberians or not. These authors have in common an emphasis on the social and institutional contexts for individual decision-making. This approach indicates that organisational social structure is to a great extent shaped by technology.
[29] See: Manuel Castells, *The Rise of the Network Society*, Oxford: Blackwell, 1996.
[30] Manuel Castells, "Information Technology and Global Capitalism," in Will Hutton and Anthony Giddens (eds.), *On the Edge: Living with Global Capitalism*, London: Jonathan Cape, 2000, pp. 52-74.
[31] See: Manuel Castells, *The Internet Galaxy,* Oxford: Oxford University Press, 2003.
[32] Manuel Castells, *End of Millenium*, Oxford: Blackwell, 1998, pp. 342-3.

Time within the neo-Weberian perspective is seen as a source of value. This approach argues that financial transactions are based on creating value from the capture of future time in present transactions. Castells goes so far as to suggest that the network society creates a timeless time: "… when the characteristics of a given context, namely, the informational paradigm and the network society, induce systemic perturbation in the sequential order of phenomena performed in that context".[33] As a result, information technology can disorganise the sequence of events and make them simultaneous. Here, the time frame of capital becomes dissolved since its future fictitious value is manipulated in the present through speculation.[34]

Embedded in the neo-Weberian viewpoint, therefore, is the assumption that financial institutions are losing their positioning as physical locations of trade since integration in financial markets tend to overcome space and time limitations. Consequently, information networks that connect financial institutions together become the non-geographical points of actual global capital operations.[35] In this way, it is argued that a new spatial form of social practices, which Castells defines as 'spaces of flows,' prevails in informational capitalism. 'Spaces of flows' are described as "programmable sequences of exchange and interactions between physically separated positions and social

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[33] Castells, *The Rise of the Network Society,* p. 464.
[34] Ibid., p. 465.
[35] See: Anthony Giddens, *The Consequences of Modernity*, Stanford: Stanford University Press, 1990; Saskia Sassen, "Locating Cities on Global Circuits," in Saskia Sassen (ed.), *Global Networks, Linked Cities,* New York: Routledge, 2002; Benjamin Cohen, *The Geography of Money*, Ithaca: Cornell University Press, 1998.

actors."[36] For Castells, places do not disappear: they become disarticulated from the organisation of power and production that dominates society.

Unlike the 'end of geography' approach, the neo-Weberian debate accounts for concrete spaces, or 'spaces of places.' 'Spaces of places' are described as the physical settings of social activity that are situated geographically in several forms, such as the local, the community, the city and the nation-state.[37] Place can be understood, according to Castells, as "the locale whose form, function, and meaning are self-contained within the boundaries of territorial contiguity. People tend to construct their life in reference to places – homes, neighborhoods, cities, regions, and countries."[38] In this approach, nation-states do not disappear with financial globalisation, but rather become delinked from the organisations of power and production that dominate society. As a result, the nation-state, as a rigid institution, is seen as an organisational structure that does not adapt effectively to the requirements of technologically driven financial markets finance and cannot ensure stability in the global financial system.[39]

The neo-Weberian perspective thus tends to advocate state policies that are focused on promoting training, skills, and other organisational assets. This, of course, is crucial if a 'space of place' is to establish itself as a node in the 'space of flows.' Also, skills and training are key to creating current account surpluses, avoiding balance of

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[36] Castells, *The Rise of the Network Society,* p. 412.
[37] Ibid., pp. 423-8; Giddens, *The Consequences of Modernity*, pp. 18-20.
[38] Manuel Castells, "Grassrooting the Space of Flows," in James O. Wheeler et al., (eds.), *Cities in the Telecommunication Age: The Fracturing of Geographies*, London: Routledge, 2000, p. 20.
[39] Anthony Giddens, *Runaway World*, New York: Routledge, 2000, p. 270.

payment deficits, and promoting the competitive clustering of firms.[40] In order to do this, the state must transform itself into a 'competition state' that formulates policies to adapt the national economy to the requirements of global finance and informational capitalism.

Since failures in policy reform, poor public management, and rent-seeking behaviour are interpreted as instances of state institutional failure, effective governance structures are regarded as a necessity. According to the neo-Weberian view, this structure needs to provide appropriate incentive systems to cope with such failures. In this respect, Castells notes:

> Played by the rules, there is nothing evil about this global casino. After all, if cautious management and proper technology avoid dramatic crushes of the market, the losses of some fractions of capital are the wins of others, so that, over the long term, the market balances out and keeps a dynamic equilibrium.[41]

To some extent, the neo-Weberian approach challenges the conventional wisdom of the rationality of investors and the perfection of the market. However, its emphasis on the effects of technological developments on investors' behaviour in financial markets remains potentially tied to an economic rationalist perspective of market perfectibility. Money market problems simply arise from poor decision-making on the part of investors and/or the state. Finance, on the one hand, is considered a neutral exchange mechanism that has become digitalised through technology, and, on the other, as a potential destabiliser of market mechanisms. As such, this perspective suggests that inappropriate expectations of future market movements must be corrected *via* customised state policy. In general terms, the neo-Weberians consider economic internationalisation to be the

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[40] Castells, *The Rise of the Network Society*, pp. 221-3; Sassen, *Cities in a World Economy*, pp. 59-60; Robert Shiller, "Risk management for the Masses," *The Economist*, 366: 83, 2000. See also: Anthony Giddens, *La Tercera Vía*, Mexico: Taurus Ediciones, 1995.
[41] Castells, *End of Millenium*, p. 363.

expansion of information technology that speeds up financial transactions throughout the world and spreads uniformly over all societies that are part of the network society. Under these conditions, this perspective suggests that nation-states need to adapt the imperatives of the informational economy to avoid exclusion from the world economy.

The neo-Weberian perspective obscures the understanding of the internationalisation of capital in the form of finance and the role of the state. It overemphasises the fluidity of capital markets due to technological innovation while portraying a submissive state whose inability to adapt to globalisation poses problems for international finance. While its analysis provides a technological explanation of the changing nature of global financial markets, it assumes that capitalism was without a global dimension before the emergence of informational-technology financial centres. This confines the transformations of global finance to a technical matter rather than a social one. Although new information technologies allow financial markets to devolve, speed up transactions, and create new trading instruments by reducing information and transaction costs, the move toward this reorganisation of finance was well under way long before these new technologies became integrated into the process. Liberalised international financial markets existed before the 1980s and 1990s, which is the period associated with the emergence of the "new informational economy."[42] It is, then, a socio-political power that needs to be assessed in financialisation, not a technological one.

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[42] For instance, British banks, encouraged by the British government, "switched their international operations from sterling to the dollar to take advantage of currency convertibility and the loosening of capital controls in Japan and Europe at the end of the 1950s." Leo Panitch and Sam Gindin, "Finance and the American Empire," in Leo Panitch and Colin Leys (eds.), *Socialist Register 2005: Global Capitalism and American Empire,* London: Merlin Press, 2004, pp. 53-4.

The neo-Weberians claim that availability and transparency of information – in other words, effective state management – is required for the well-functioning of financial markets. This renders financial globalisation an apolitical and inevitable process that gives advantages to states and investors who play according to the rules of the market. Thus, financial markets and the crises that accompany them become treated like a managerial issue.

To argue that the 'spaces of flows' of international financial markets overcome the 'spaces of places' of the nation-state is to ignore the fact that decisions and policies are produced and reproduced through a national form. This pattern of reproduction reinforces the role of the nation-state in the process of technological innovation and capital mobility and in creating the necessary conditions for production and the circulation of capital. As David Coates notes, technological innovation facilitates financial capital mobility, but it does not create it or trigger it: "Financial globalisation is a process based less on the proliferation of computers than on the proliferation of proletariats."[43] In other words, financial markets depend on the dispossession of people's land and labour, so they can enter into the labour market in order to transform investors' claims of future profit into money in the form of corporate profits as well as government payments on public debt. 'Spaces of flows' are never delinked from 'spaces of places.' Rather, they are reproduced through the territoriality of those places – namely nation-states and the spaces of production.[44]

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[43] David Coates, *Models of Capitalism*, Cambridge: Polity Press, 2000, p. 255.
[44] Greg Albo, "A World Market of Opportunities? Capitalist Obstacles and Left Economic Policy," in Leo Panitch (ed.), *Socialist Register 1997: Ruthless Criticism of all That Exists,* New York: Monthly Review Press, 1997, p. 8.

The neo-Weberians portray a pessimistic view of state territorial power. This, in turn, tends to simplify the complexity of financial restructuring into dichotomising and totalising conceptualisations of 'spaces of flow' and 'places.' As such, it overlooks the fact that the social implications of new technology and financial innovation depend on economic, legal, and policy decisions within territorial nation-states that shape finance and informational technology.

Capital and International Relations: International Political Economy

While both the economic rationalist and the neo-Weberian approaches consider financial globalisation and deregulation as apolitical and inevitable phenomena, International Political Economy (IPE) regards this globalisation today as the result of political processes derived from the state. As Susan Strange notes, "it is very easily forgotten that markets exist under the authority and the permission of the state and are conducted on whatever terms the state may choose to dictate or allow."[45] IPE analyses therefore consider financial deregulation to have been politically engineered by those same capitalist nations that gained from encouraging 'free markets in global finance. Thus, in opposition to the 'end of geography' and the 'spaces of flows' thesis, this approach asserts that the nation-state was crucial in constituting and carrying out financial restructuring.

The IPE approach emerged, to a great extent, in response to the theoretical and political discontent with the hegemonic decline school of neorealism. Neorealist international relations theory infers that present economic changes relate to the inability

[45] Susan Strange, *Casino Capitalism*, Oxford: Blackwell, 1986, p. 29.

of states, particularly the American state, to accommodate to the requirements of a global market.[46]

In contrast, IPE considers transformations in the global economy to have been nurtured and encouraged by a series of government decisions (or non-decisions), particularly those of the United States.[47] Eric Helleiner, for instance, addresses the question of why states decided to embrace a liberal international financial architecture after their opposition in the years after the Second World War. Helleiner argues that states decided to promote financial deregulation since their impacts have low political visibility:

> States also did not experience collective actions problems in liberalizing capital controls because a primary benefit of financial openness was the ability of a state to attract footloose global capital and financial business to its own territory. Therefore, few risks were associated with the unilateral liberalization, nor were many specific relative gains to be obtained by retaining controls.[48]

Unlike trade policies, which affect particular groups such as unions or the manufacturing sector, according to Helleiner, financial liberalisation does not target a specific group. Its costs are dispersed at the macro-economic level. Preservation of a global financial market, moreover, does not require collective coordination between states as liberalisation does, since decisions to deregulate financially can be made unilaterally.[49]

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[46] This perspective notes that this is particularly evident in the case of the United States, which has not subordinated its domestic interests to the international ones. As a result, the international system has become unstable due to the weakening of political leadership exercised by the United States. See: Robert Keohane, *After Hegemony*, New Jersey: Princeton University Press, 1984; Robert Gilpin, *Global Political Economy: Understanding the International Economic Order,* New Jersey: Princeton University Press, 1987.

[47] See: Eric Helleiner, *States and the Reemergence of Global Finance*, Ithaca: Cornell, 1994.

[48] Ibid., p. 196.

[49] Ibid., pp. 197-205.

Susan Strange further suggests that the value of any currency depends on "financial flows moved by the moods of the market more than on those moved by the balance of trade in the real economy."[50] The sphere of policy-making – that is, trade in the real economy – becomes subordinated to the flows of financial markets. According to this perspective, the opening of financial markets has shifted power from the state to markets despite the participation of the state in globalising finance. There is, however, one exception. In their role as lender-of-last resort, states become more important in relation to the market when financial markets become vulnerable to major crises.[51]

Within the IPE approach, Robert Cox examines the structures of social power generated by the internationalisation of production in the current world order. According to Cox, a world order is the persistent pattern of ideas, institutions and material forces that create historical structures and transcend particular societies.[52] This world order conditions the state and simultaneously expresses the social relations of production.[53] The current world order, Cox argues, is characterised by the internationalisation of production – that is, the relatively free movement of corporate production facilities from one country to another. In this context, state regulations have little consequences on "the relatively free movement of goods, capital and technology."[54]

Stephen Gill and David Law, drawing from Cox's work, consider that the current historical structure is also characterised by the predominance of the power of capital at

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[50] Susan Strange, "From Bretton Woods to the Casino Economy," in Stuart Corbridge, et al., *Money, Power and Space*, Oxford: Blackwell, 1994, p. 59.
[51] Helleiner, *States and the Reemergence of Global Finance*, pp. 188-9.
[52] Robert Cox, *Production, Power and World Order*, New York: Columbia University Press, 1987, p. 106.
[53] Cox, *Production, Power and World Order*, p. 11.
[54] Robert Cox, "Social Forces, States and World Orders," in Robert Keohane (ed.), *Neorealism and Its Critics*, New York: Columbia University Press, 1986, p. 230.

the level of world order. The power of capital, it is argued, imposes discipline on the state and civil society. This power manifests itself in two manners: the behavioural power of capital and the structural power of capital. On the one hand, the behavioural power occurs when "a given group of capitalists seeks to exert direct power and influence over others or the state apparatus" to create a favourable environment for their business.[55] The structural power of capital, on the other hand, is the normative and material structures through which capital exerts power over society and the state indirectly through market mechanisms. Structural power originates from the ability of capital to move between countries and hence conditions the behaviour of governments, dependent firms, and trade unions.[56] "As a result, governments are increasingly constrained by the economic policies of other states, as well as the investment decisions of internationally mobile capital."[57]

According to Cox, the state has not been hollowed out in the current historical period. Rather, the state has been transformed through an internationalisation of the state. "The internationalising of the state is the global process whereby national policies and practices have been adjusted to the exigencies of the world economy of international production."[58] In this process, nationally-oriented agencies become subordinated to key

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[55] Stephen Gill and David Law, "Global Hegemony and the Structural Power of Capital," in Stephen Gill, (ed.), *Gramsci, Historical Materialism and International Relations,* Cambridge: Cambridge University Press, 1994, pp. 93-124.
[56] Stephen Gill, *American Hegemony and the Trilateral Commission*, Cambridge: Cambridge University Press, 1991, p. 113
[57] Stephen Gill and David Law, "Global Hegemony and the Structural Power of Capital," *International Studies Quarterly*, 33: 4, 1989, p. 485.
[58] Cox, *Production, Power and World Order,* p. 254.

organisations in charge of adjusting national policy to international economic policies.[59] Cox also focuses on the crucial functions that the state has to perform as production becomes internationalised. These functions guarantee private property and ensure that there are no obstructions to the global market.[60] The IPE view emphasises that the internationalisation of capital in the world order has entailed a radical transformation of the state, namely the relative decline of state power.

The IPE approach brings politics back into the debate, and thus allows for a more comprehensive understanding of financial internationalisation. It does not ascribe technological determinism to the internationalisation of capital or to the limits of the state. Rather, in this view, the political organisation of state institutions and state decisions have led to the opening of financial markets.

IPE also contends that the state itself has changed the way in which state and markets operate. These transformations have resulted in the internationalisation of production, namely the free movement of goods, the mobility of finance, and the expansion of corporate investment overseas through transnational corporations. Finance does not appear as neutral exchangeable assets, but rather as an external economic process and set of institutions that pressure nation-states and affects negatively productive activities and workers. This analysis does not argue for the disappearance of

[59] Cox, *Production, Power and World Order*, p. 253.
[60] Leo Panitch, "Globalisation and the State," in Ralph Miliband and Leo Panitch (eds.), *Socialist Register 1994: Between Globalism and Nationalism*, London: Merlin Press, 1994, p. 69.

the state. Rather, "different forms of the state facilitate this tightening of the global-local relations for countries occupying different positions in the global system."[61]

Still, this debate sees the state and the market as regulatory institutions that are necessarily antithetical to one another – when the authority of one increases, that of the other must correspondingly decline. The state thus responds mainly in a passive way to the demands of mobile capital. As Strange notes:

> The impersonal forces of world markets, integrated over the postwar period more by private enterprise in finance, industry, and trade than by cooperative decisions of governments are now more powerful than states to whom ultimate political authority over society and economy is supposed to belong.[62]

Also, the internationalisation of the state is seen as the result of external obligations imposed from above by the world order. The internationalisation of the state and capital is closely related to the international and external impositions of the structural and behavioural power of capital. Thus, internationalisation of production and finance appear to have a homogenous effect in all countries. As a result, the influence of domestic class relations in shaping national policies of economic adjustment is overlooked. This conceals the ways in which the internationalisation of the state is an aspect of capitalist social relations and how, to some extent, "its power lies in its ability to organise and reorganise capital-labour relations within its boundaries."[63]

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[61] Robert Cox, "Global Restructuring: Making Sense of the Changing International Political Economy," in Richard Stubbs and Geoffrey Underhill, (eds.), *Political Economy and the Changing Global Order*, Toronto, 1994, p. 49.
[62] Susan Strange, *The Retreat of the State*, Cambridge: Cambridge University Press, 2000, p. 4.
[63] Peter Burnham, "The Politics of Economic Management in the 1990s," *New Political Economy*, 4: 1, 1999, p. 30.

Towards a New Regime of Accumulation: The Regulationist School

The Regulationist school has argued that the current role of finance has altered with the shift from one regime of accumulation to another. This is explained in terms of regimes and modes of accumulation that allow for an interpretation of periods of coherence and transformation in the economy. The accumulation regime, on the one hand, comprises the productive system and follows a certain tendency of growth in capital stocks and wages linked to a given technological trajectory. The mode of regulation, on the other, consists on an ensemble of institutions – the wage relation, monetary relations, relations of competition between capitals, the international regime, and state intervention – which act to guide and stabilise the accumulation process.[64] This allows the Regulationist school to place a particular focus on institutions as endogenous economic factors.[65] As a result, this approach argues that market-economies are not self-equilibrating, as accumulation depends on extra-market institutions for the successful reproduction of capitalist relations.

The Regulationist school contends that industrialised countries were characterised by a Fordist regime of accumulation based on mass production, and, crucially the role of workers' wages in providing the purchasing power for aggregate demand rather than just as an operational cost element of capitalist expansion. The welfare state and productivity bargaining became the predominant mode of regulation sustaining the growth of consumer markets in the industrialised world. The Regulationist perspective argues,

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[64] John Grahl and Paul Teague, "The Regulation School, the Employment Relation and Financialization," *Economy and Society*, 29: 1, 2000, p. 16.
[65] Bob Jessop, "Twenty Years of the Parisian Regulationist Approach: The Paradox of Success and Failure at Home and Abroad," *New Political Economy*, 2: 3, 1997, p. 506.

however, that the Fordist regime of accumulation weakened during the 1970s, and brought on the profitability crisis that signalled its end. Accordingly, the Fordist accumulation regime was supplanted by a flexible and finance-oriented process under this dynamic of crisis and economic liberalisation. However, the Fordist mode of regulation continued to dominate the logic of state involvement in the economy, and thus became a key political battleground for restructuring.[66]

The 1970s crisis itself did not cause prices or production to collapse, but manifested itself as simultaneous stagnation and inflation – a rather contradictory notion at the time. According to the Regulationist school, stagflation was not triggered by state policy as such.[67] The root of the problem was an apparent mismatch between the outdated mode of Fordist regulation and the novel regime of accumulation driven by finance. More specifically, the state failed to adapt to the changes taking place on the economic front.

This perspective argues that the crisis occurred under conditions of the internationalisation of production. As with the IPE approach, internationalisation is defined as a firm's investment in low wage locations worldwide and the emergence of globally integrated production chains. The connection between corporations, their structures of production and distribution, and their territories of origin has weakened as

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[66] Bob Jessop, "Twenty Years of the Parisian Regulationist Approach," p. 511.
[67] See: Bob Jessop, "Fordism and Post-Fordism: a Critical Reformulation," in Allen Scott and Michael Storper, (eds.), *Pathways to Regionalism and Industrial Development*, London: Routledge, 1992.

firms have circumvented the national regulations that formerly shaped the path of accumulation.[68]

As a result of the crisis of Fordism in both industrialised and peripheral countries, the Regulationist school points a transition towards a new finance-led regime of accumulation. Aglietta's recent notion of a patrimonial growth regime analyses the elements of organisation and coherence in the current neoliberal economic expansion since the 1990s, particularly in the US.[69] Aglietta attempts to identify the types of financial systems promoted by liberalisation – an open market system and a liberalised banking system – and how these have impacted corporate strategies.[70]

Boyer, in contrast, views a financialised economy as a situation where the population as a whole holds a significant amount of financial assets and where financial markets impose strict profitability norms on productive enterprises:[71]

> Many giant mergers, capital mobility between countries, pressures on corporate governance, diffusion of equity among a larger fraction of population; all these transformations have suggested the emergence of a finance-led accumulation regime. This would lead to a totally novel regulation mode, currently labelled "the new economy;" this regime would combine labour-market flexibility, price stability, developing high tech sectors, a booming stock market and credit to sustain the rapid growth of consumption, and permanent optimism of expectations in firms.[72]

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[68] Michel Aglietta, "Capitalism at the Turn of the Century: Regulation Theory and the Challenge of Social Change," *New Left Review*, 232, p. 67

[69] Michel Aglietta, "Shareholder Value and Corporate Governance: A Comment on Some Tricky Questions," *Economy and Society*, 29: 1, 2000, pp. 146-59.

[70] Michel Aglietta and Breton Regis, "Financial Systems, Corporate Control and Capital Accumulation," *Economy and Society*, 30: 4, 2001, p. 435.

[71] Robert Boyer, "Is a Finance-led Growth Regime a Viable Alternative to Fordism? A Preliminary Analysis," *Economy and Society*, 29: 1, 2000, pp. 111-45.

[72] Boyer, "Is a Finance-led Growth Regime a Viable Alternative to Fordism?" p. 116.

Boyer's approach is particularly concerned with the adaptation of each national economy to this new regime of accumulation. He suggests that national adjustment to financialisation "would be a key factor in macroeconomic performance and would determine that country's place in a hierarchical world economy governed by the diffusion of a financialised growth regime".[73] These recent reformulations of the Regulationist school point to the primacy of monetary relations and the international regime over the wage relation and state intervention in the current period.[74]

The Regulationist school provides an insightful understanding in how accumulation is always accompanied by state institutions. Furthermore, money, as a central element in capitalism, is not seen as neutral, nor is speculation viewed as the product of irrational investor behaviour. Rather, the Regulationists regard speculation and the predominance of finance as having an influence on accumulation and production. As Aglietta notes:

> [c]aught in the vice between fierce competition in product markets and high profit requirements in financial markets, corporate management has responded with cost-cutting, restructuring through shedding and acquiring product lines, outsourcing, and the like.[75]

Like the IPE school, the Regulationist approach sees internationalisation as the international reallocation of production and the free mobility of goods and finance. The Regulation approach make a distinction between finance and production, where finance as an institution belongs to the international sphere and the wage-labour nexus belongs to the nation-state. Again, this conception neglects the ways in which capital as a social

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[73] Boyer, "Is a Finance-led Growth Regime a Viable Alternative to Fordism?" p. 116.
[74] The wage relation and state intervention between capital and labour are considered within the Regulationist framework as two institutions with pre-eminence during the Fordist period.
[75] Aglietta, "Shareholder Value and Corporate Governance," p. 155.

relation expands through the expansion of production *via* money and commodities. This, in turn, fragments these aspects of capitalism into different economic activities, leading to a dichotomisation of the real economy and finance. The only perceived articulation between the real and financial economy is the channelling of profits to corporate share value rather than to productive investment. As Dick Bryan and Michael Rafferty point out, this emphasis on corporate shares is misleading since the stock market only has a limited role in raising funds.[76] This stress on corporate share value also leaves unexamined how the nation-state mediates and reproduces the profitability of firms and finance *via* economic policies.

Under the Regulationist school, contradictions and competition between the sphere of circulation and production are seen as a new form of competition at the international scale.[77] Notions of state restructuring and internationalisation, as a response to crisis, lead to a search for a new model or mode of regulation that is coherent with the finance-led regime of accumulation. This approach suggests an adaptation of state institutions to solve the transition crisis towards a new financial regime. The main question for Regulation theory is not the essentially contradictory character of the capitalist system but the how state can adapt and manage the new system of reproduction. This occurs because the nation-state is not seen as being necessary to accumulation regimes, but rather it is seen as an outcome, one that is contingent upon the process of adaptation of political institutions to the economy. In this way, the Regulationist

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[76] Dick Bryan and Michael Rafferty, *Capitalism with Derivatives: A Political Economy of Financial Derivatives, Capital and Class*, London: Palgrave, 2006, p. 32.
[77] Greg Albo, "The Old and New Economics of Imperialism," in Leo Panitch and Colin Leys, (eds.), *Socialist Register 2004: The New Imperial Challenge,* New York: Monthly Review Press, 2004, p. 116.

perspective ignores the social relations that the state is trying to regulate and that sustain the regime of accumulation.

Global Capitalism and National States: Open Marxism

The Open Marxist approach has argued that the Regulationist school's concern with institutions and its role in sustaining the coherence of capitalism overlooks the centrality of class struggle in the process of accumulation. It suggests that the institutions of Fordism were not elements of a coherent mode of regulation; they were the forms that class conflict took within the state. Open Marxism also differs from the Regulationist school in its view of global accumulation and argues that "the global system does not comprise an aggregation of compartmentalised units, but is rather a single system in which state power is allocated between territorial entities."[78] The Open Marxist perspective stresses the importance of the breakdown of the Bretton Woods regime and its impact on monetary relations, states, and labour in understanding the imposition of monetary austerity upon labour and the state.

According to Werner Bonefeld, the abandonment of the Bretton Woods regime led to a dissociation of money capital from the exploitation of labour. More specifically, the labour movement's fight for better wages triggered currency speculation and capital flight. The movement of capital into globally integrated markets followed the collapse of the Bretton Woods system and integrated a multiplicity of states on the basis of floating

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[78] Peter Burnham, "Capital, Crisis and the International State System," in Werner Bonefeld and John Holloway (eds.), *Global Capital, National State and the Politics of Money*, New York: St. Martin's Press, 1995, p. 103.

exchange rates. This imposed monetary discipline over the national organisation of money and labour *via* speculation over national currencies:[79]

> [The states'] capacity of imposing austerity upon the working class is "policed" through speculative capital movements... While governments might have been tempted to inflate the debt away and thereby reduce the burden of debt on many firms as well as eroding real wages and standards of living, speculative runs on currency would have resulted in a liquidity crisis, reinforcing the fiscal crisis of the state and making it more difficult to finance balance of payment deficits.[80]

The discipline imposed by international movements of capital over labour and the state allows the Open Marxist perspective to elaborate on a chronic conflict between the global nature of capitalist accumulation and the national, territorially bounded character of the state. This is expressed, in turn, in the limitations that global accumulation of capital imposes on nation-states. As a result, the state faces a dilemma in its organisational structure. While the participation of states in global accumulation remains necessary to secure international property rights as the basis for capital expansion, this also poses itself as a potential disadvantage that can undermine the economic strategies of any particular national state.[81]

There exists a fundamental contradiction between the mobility of capital and the immobility of the nation-state. As John Holloway argues, "the aspatial global nature of social relations is a central feature of capitalist development."[82] More specifically, there is a spatial liberation of the process of exploitation, so that money flows to those places

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[79] Werner Bonefeld, "Monetarism and Crisis," in Werner Bonefeld and John Holloway (eds.), *Global Capital, National State and the Politics of Money*, St. Martins Press, 1995, pp. 48-57.
[80] Werner Bonefeld and Peter Burnham, "Britain and the Politics of the European Exchange Rate Mechanism: 1990-1992," *Capital and Class*, 60, 1996, p. 37.
[81] Burnham, "Capital, Crisis and the International State System," p. 105.
[82] John Holloway, "Global Capital and the National State," in Werner Bonefeld and John Holloway (eds.), *Global Capital, National State and the Politics of Money*, New York: St. Martin's Press, 1995, p.125.

where profit is higher. In contrast, "the territorial definition of the state means that each state is immobile in a way that contrasts strongly with the mobility of capital."[83] As such, the Open Marxism school sees the global nature of capital accumulation as a phenomenon inherent in capitalist relations of exploitation – a relation they see as freed from spatial constraints.[84]

The Open Marxist debate portrays finance as an aspect of social relations and sees the global nature of capital as the expansion of class relations. The state is also considered as a moment of the global and as a facilitator of global accumulation. This view, however, takes for granted the national form of the state and presents the 'international' as an exogenous and preconceived totality in which nation-states are subordinated to global accumulation. While the state is considered static and fixed, the internationalisation of capital is portrayed as a dynamic process. This results into a dichotomisation of the global mobility ascribed *a priori* to capital and the immobility attributed *ex-ante* to the state. Consequently, this theory assumes that capitalist contradictions are located in the incongruity of the national space of the state and the global space of capital, isolating the nationality of the state from the internationality of accumulation.

The connection between finance and its effects on nation-states, production, and labour is seen as a given external and mechanical relation. Money appears in the Open Marxist framework as an external mechanism, which turns into Ponzi finance that obstructs the process capitalist accumulation in the form of speculative financial

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[83] John Holloway, "Global Capital and the National State," p. 125.
[84] Ibid., p. 123

bubbles.[85] While the social power dimension of money is considered, the complexities and processes through which finance and production move internationally are concealed.[86] As a result, this approach cannot explain why finance is essential to the capital relation. Nor does this approach explain how current financial developments have affected the capital relation since the only perceived change in the nature of money is its mobility, which reproduces this dualistic opposition between the static territoriality of the state and the global mobility of capital.

The National Scale of the State *Versus* the Globality of Capital?

These approaches all remain ambiguous in explaining the articulation of the nation state to global accumulation. This is due to a continuous ontological separation of the two as uncorrelated units of analyses. The 'whole' – the global economy – governs nation-states or *vice versa*. The relationship is never reciprocal. This is seen, for instance, in assumptions that regard the capitalist system as the sole determinant of the internal dynamics of the nation-state. Similarly, the nation-state is considered as a given regulatory space that, in an aggregate with other nation-states, constitutes global accumulation.

These approaches also privilege time over space in the process of internationalisation. It is argued that financial transactions exert dominance in the

[85] Hyman Minsky argued that there are three categories of debt structures: hedge finance, speculative finance and Ponzi finance. Hedge finance takes place when cash flows are expected to exceed the cash flow commitments on liabilities for every period. Less sound speculative finances occur when cash flows, although inadequate to fully service debt in the short-run, are generally sufficient over the longer-term. Ponzi finance is when cash flows from assets in the near-term fall short of cash payment commitments. The borrower is then forced to increase outstanding debt in order to meet its financial obligations in a continuing cycle. Doug Henwood, *Wall Street: How it Works and for Who,* New York: Verso, 1998, pp. 221-3.

[86] For instance, central bank decisions have different effects on capital markets – equities, public securities, etc. and *vice versa.*

economy because of the technological speed and the unregulated environment in which these ventures operate. The mobility of financial transactions and their ability to appropriate value out of the capture of future time in present transactions – futures, options, and other derivative capital markets – allow for financial capital's control over the process of production. Within these views, financial mobility plays a coercive role in determining the policies of nation-states, particularly in developing countries. The internationalisation of capital is seen as constituted by the obliteration of space through time and as the exclusive site of the circulation of capital.

It is important to reiterate that the stress on time in these approaches leads to the subordination of space in understanding socio-economic relations within the nation-state. They see financial transactions, and the social relations embedded in them, as cut-off from the material environment. As a result, the 'international' becomes the sole source of change. The territorially-bounded social relations that the processes of internationalisation produce and reproduce become marginalised. In this way, the social agents that participate in these processes, and indeed execute them, become greatly overlooked. As a result, financial internationalisation appears as a process without social subjects. Global finance seems activated by automatic mechanisms – market mechanisms of supply and demand, speed in technological transactions, and the mechanical effect of financial speculation and capital flight over production – that 'blindly' facilitate the movement of commodities and money. Internationalisation is then seen as having a homogeneous effect on each social formation. The notion that the

"world is flat" is the ultimate representation of this in the work of the journalist Thomas Friedman.[87]

These gaps in the literature do not allow an understanding of the contradictions "within internationalised accumulation and within nation-states themselves."[88] An alternative interpretation that can shed light on this contradictory relationship requires an account of Karl Marx's conception of the spatial dimension of the circuit of capital. A discussion of the internationalisation of capital through the circuit of social capital, therefore, offers an explanation of the moments of capital as parts of spatial social processes that create a larger whole. Such a view also allows for the integration of finance, state power, and territoriality as integral dimensions of the international expansion of capital.

Money, Finance, and the Circuit of Capital

In order to describe the functioning of the modern financial system, it is necessary to integrate an analysis of money and credit in the current phase of capitalism. Karl Marx makes a distinction between capital and money in order to understand the form that money takes under capitalism, and the power relations that money transforms and comprises. In this sense, Marx notes that money and credit existed in various modes of production other than capitalism without giving rise to the capital relation. Hence, the existence of money does not require the existence of capital as a historical precondition

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[87] See: Thomas Freedman, *The World is Flat*, New York: Farrar, Strauss and Giroux, 2005.
[88] Dick Bryan, *The Chase Across the Globe: International Accumulation and Contradictions for Nation States*, Boulder: Westview Press, 1995, p. 43

or as a theoretical premise. This led Marx to consider the specificity of money under capitalism compared to other social formations.

For Marx, capital expresses a social relation and a continuous movement of value represented by M-C...P...C’-M,’ where M is money, C is commodities, and P is production with C’>C and M’>M. This is, in other words, the process of capital being valorised.[89] The specific social relation that capital expresses is contained in P, the relation between the owners and non-owners of the means of production. Under capitalism, private labour or use-value is transformed into social labour or value when labour power is turned into capital. This power, in turn, implies the transformation of labour power into surplus value.

Within capitalist social relations, money acquires a new social function. For Marx, money wages paid to workers integrate them into the process of production. This, in turn, creates conditions in which workers depend on wages to live. As such, money does not exist in a different monetary sphere apart from the ‘real economy,’ as economic rationalist theorists argue. Rather, money is intrinsically articulated to the process of capital accumulation through its role in expressing value.[90]

In this process, money represents the autonomous embodiment and expression of the social character of wealth that measures and circulates value.[91] Also, capitalism homogenises social relations through money. Money allows for personal social bonds to

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[89] Karl Marx, *Capital: A Critique of Political Economy Volume I,* London: Pelican Books, 1976, pp. 247-306.
[90] David Harvey, *Justice, Nature, and the Geography of Difference*, Oxford: Blackwell, 1996, p. 63.
[91] David Harvey, *Limits to Capital*, Verso: New York, 1999, p. 293.

be broken and replaced by objective dependency relations.[92] Different labour activities with specific qualities and distinct socio-political conditions are equated to and represented through the abstract measure of money.[93] In this way, money becomes alien to the very labour process that creates it and makes money circulate.[94]

Marx's notion of capital and money does not only refer to a set of financial claims or an unproblematic stock of assets that exist in material form. For Marx, capital is conceptualised as a social relation rather than as a thing and money is seen as a dimension of this relation. Marx's main point is that stocks of assets or financial claims cannot have causal power over human agency, and those assets must be understood in terms of the social processes that reproduce them.[95] Capital, consequently, is a sum of commodities of exchange values that preserves itself and multiplies by exchange with direct, living labour-power.[96] The existence of a class which possesses nothing but the ability to work under conditions of competition is a prerequisite for the existence of capital. Capital, therefore, is a social relation and a process whereby value is created and reproduced.[97]

Marx notes that capitalism has relied on different forms of money to emerge and reproduce itself. One of these forms of money was credit. Credit relations existed before capitalism, and they were linked to trade. Under capitalism, credit relations and finance take on new dimensions because capitalists can now finance, and speculate on, future

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[92] David Harvey, *The Urban Experience*, Baltimore: John Hopkins University Press, 1989, p. 167.
[93] Marx, *Gundrisse: Foundations of a Critique of Political Economy*, p. 157.
[94] Ibid., p. 168.
[95] David Harvey, *Justice, Nature, and the Geography of Difference*, Massachusetts: Blackwell, 1996, p. 63.
[96] Karl Marx, *Wage Labour and Capital*, Moscow: Progress Publishers, 1978, p. 40.
[97] Richard Bryan, "The State and the Internationalisation of Capital: An Approach to Analysis," *Journal of Contemporary Asia*, 17: 3, 1987, p. 259.

production and exploitation. Marx argued that the constitutive elements of the credit system are the initial development of commercial credit and the usage of commercial bills to substitute for money as a means of circulation among capitalists. Commercial credit follows from money's function as a means of payment, and culminates its usage for settling balances among capitalists. The credit system temporarily solves coordination issues between circulation, production and realisation through its ability to "promote the dovetailing of diverse activities, a bourgeoning division of labour and reduction in turnover times... It helps to coordinate the relations between flows of fixed and circulating capital."[98]

The credit system within capitalism also gives rise to various forms of fictitious capital. This refers to the money capital advanced through the credit system based upon future labour and value flows as opposed to current collateral or existing commodities.[99] Marx describes fictitious capital this way:

> [A] large portion of this money-capital is always necessarily purely fictitious, that is, a title to value – just as paper money. In so far as money functions in the circuit of capital, it constitutes indeed, for a moment, money-capital; ... it exists only in the form of claims to capital. With the assumption made, the accumulation of these claims arises from actual accumulation that is from the transformation of the value of commodity-capital, etc., into money; but nevertheless the accumulation of these claims or titles as such differs from the actual accumulation from which it arises.[100]

Marx associated the emergence of fictitious capital with growing complexities in the organisation of capitalism, particularly with the development of the banking system and the joint-stock corporation. As David Harvey suggests, "the credit system facilitates

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[98] Harvey, *Limits to Capital*, p. 284.
[99] Ibid., p. 267.
[100] Karl Marx, *Capital, A Critique of Political Economy Volume III*, London: Pelican Books, 1981, p. 296.

the centralisation of capital and allows capital to break free from the fetters of the family firm and to operate as corporate capital."[101] The banking system combined the savings of all social classes and transformed them into credit, thereby advancing money capital and establishing a claim over a share of future surplus value. In the case of the joint-stock corporation, the creation of a stock represented a property entitlement over future production.

The coupling of a complex credit system and corporate property forms, both based on future events, has had several important institutional consequences. Marx anticipated such a process as leading to the socialisation of capital. By centralising capital, the credit system gave capitalists an absolute command over the capital and property of others "and through this, command over other people's labour."[102] The amalgamation of capitals through the credit system provided a mechanism in which diverse activities, a greater division of labour, and investment decisions between fixed and circulating capital can be combined and coordinated across the economy. However, such interdependence not only ties labour and other capitals together, but also makes their existence more volatile.

Thinkers such as Rudolph Hilferding elaborated on Marx's insights on money and the credit system to develop the concept of finance capital. According to Hilferding, finance capital is the fusion of industrial capital and banking capital into one single bloc. He argues that as the credit system becomes highly developed, it centralises capital of all

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[101] Harvey, *Limits to Capital*, p. 285.
[102] Karl Marx, *Capital: A Critique of Political Economy Volume II,* London: Pelican Books, 1981, p. 570.

classes and transforms it into social capital.[103] Hilferding notes that banks are the more powerful side in this relationship because of the ability of money capital to be relatively autonomous from the production sphere and decide the allocation of credit money among different sectors. This independence gives banking capital power over the industrialist whose capital is tied up in the productive process.[104]

Harvey argues that Hilferding fails to internalise the contradiction between the financial system and the monetary system in the unity of the industrial and financial capitals. Harvey thus proposes an understanding of finance capital, not as the dominance of one capitalist faction over another, but rather as a process within the circuit of capital unifying productive and financial activities. In other words, finance capital can be seen as the mobilisation and the accumulation of capital as money.[105] This contradictory relationship then indicates that financial operations are not autonomous from the sphere of production, but rather that these two moments in the circuit – money and commodities – exist in continuous interdependence and opposition within capital accumulation as a whole. By looking at the relationship between money, credit, and actual labour processes through the concept of finance capital, finance ceases to exist as a particular institutional arrangement or the domination of a particular faction of the bourgeoisie. Instead, finance exists as a process within capitalism and a dimension of capitalist social relations.

The ways in which the financial system has developed in the past three decades has transformed the organisation of capitalism. Since the 1970s, the forms of credit

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[103] Rudolph Hilferding, *Das Finanzkapital,* London: Routledge, 1981, p. 225.
[104] Hilferding, *Das Finanzkapital*, pp. 367-8.
[105] Harvey, *Limits to Capital*, p. 319.

operating in the world of finance – future, commodity speculation, the purchase and sale of debt itself – have far outstripped paper money. These financial developments have played an important role in shaping economies. One of these financial instruments is derivatives. Derivatives are a two-party financial contract, the worth of which is derived from the value of some underlying asset (a currency, security, or commodity), reference interest rate (a rate based on the prime), or index (Standard and Poor Index). They can be futures, options, and swaps contracts and can be traded in specific market places or by a private arrangement called Over the Counter (OTC) transactions.[106]

Certain characteristics of derivatives have important implications in the workings of the financial system and the functioning of capitalism. These features are derivatives' ability to link assets in the present to prices in the future and blend different forms of assets together (e.g. exchange rates and commodities). Derivatives can also transform any commodity, risk, or asset into a financial measure and separate this asset from its price.[107] These characteristics have a great impact on the way ownership operates since derivatives can be traded without owning the underlying asset.

Derivatives represent capitalism's tendency to speed up the reproduction of the circuit of capital. Derivatives, as a more sophisticated form of money, anticipate the realisation of production and other forms of money exchange before these two processes take place. Financial innovation, therefore, clearly indicates the tendency of capitalism to diminish the social time necessary to reproduce the circuit of capital. Still, it is worth noting that the social structures that reproduce the production process and national

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[106]Thomas McInish, *Capital Markets*, Massachusetts: Blackwell, 2000, p. 304
[107] Dick Bryan and Michael Rafferty, *Capitalism with Derivatives*, New York: Palgrave, 2006, p. 10.

moneys exist within concrete spaces. As such, the circuit of capital is not devoid of a spatial dimension, but rather depends on territoriality to guarantee its continuity.

Space and the Internationalisation of Capital

The spatial dimension of the circuit of capital is integral to an important contradiction within the different moments of capital. On the one hand, production disrupts circulation of capital since the creation of value through the labour process requires time to transform the commodity capital that was put into production. Production also takes place in a specific, territorially definite location. This moment is essential in the circuit since it creates surplus value and guarantees the continuity of the circuit of social capital. On the other hand, capital does not move in the form of production, but rather the latter can only be repositioned by changing the site of the productive process via the movement of the other forms of capital, namely money and commodities. Money, therefore, allows for the movement of capital at an international scale. At the same time, money and production have a contradictory relationship that reproduces the circuit of social capital as a whole.

Still, the ability of money to circulate internationally does not entail the absence of a territorial dimension of this form of capital. "Money is geography" because it needs to expand geographically and link different territories in order to reproduce the capital relation internationally.[108] Harvey argues that:

> It is the interconnections of money, space, and time as intersecting sources of social power that in the end matter. Money can thus be used to command time

[108] Andrew Leyshon and Nigel Thrift, *Money/Space, Geographies of Monetary Transformation*, London: Routledge, 1997, p. 1.

> and space, while command over time and space can easily be played back into command over money.[109]

This, in turn, shows that the spatial structure of the financial system is far from neutral in its effects. Rather, it influences the allocation of funds, capital and credit across regions and localities.

How, then, does internationalisation relate to the circuit of social capital and its spatial dimension as a whole? The overcoming of spatial barriers does not refer to internationalisation as the spatial expansion of an isolated or singular moment of the capital circuit. In other words, capital internationalisation is not the increase of foreign ownership, the reallocation of multinational corporations, the mobility of money through finance, or the increase in trade relations among nation-states. Rather, more generally, and indeed more accurately, it points to the spatial spreading of capital as a social relation.

In this respect, Christian Palloix states that the internationalisation of capital as a social relation in the moment of production is a precondition for the international extension of the area of capital expansion in the form of money capital and commodities. In other words, labour power has to become a free commodity at every point in the world for the circuit of capital to be internationalised and/or so that non-capitalist relations are integrated and subordinated to international capital accumulation.[110]

The capital relation also expands at the international scale through the crossing of capitals. Money and its transformations remains the main instrument of class power that

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[109] David Harvey, *The Urban Experience*, Baltimore: John Hopkins University, 1989, p. 186.
[110] Christian Palloix, "The Internationalisation of Capital and the Circuit of Social Capital," in Hugo Radice (ed.), *International Firms and Modern Imperialism,* Middlesex: Penguin Books, 1975, p.75.

provides continuity to capital accumulation. Money is key in providing the conditions and accelerating the ways in which individual circuits cross each other. Individual capitals cross with one another through the movement of money in order to expand and secure its own reproduction internationally. Hence, "the duration of the production process of capital B thus appears as a moment in the circulation process of capital A."[111] This also results in a process where individual capitals might take their share of the profits from the surplus value produced by other capitals. In this way, the reproduction of capital, even within a nation-state, is tied and intersected with the reproduction of other capitals at an international scale.[112]

Thus internationalisation occurs not only as circulation and realisation take place internationally, but also as individual capitals are crossed by others at the international scale. This allows for the insertion of different capitals into exchange relations, bringing continuity to the total circuit of social capital. The crossing of individual capitals through the financial system then allows for the amalgamation of all capital together and provides the conditions for the creation and trading of standardised claims on the capital and property of others – in other words, the command over others' labour.[113] As a result, innumerable spatial substitutions can take place between different temporal processes. In this way, finance bridges temporarily the gap between production on the one hand and realisation and consumption on the other. Individual capitalists are able to receive money on account of a production process that has not been completed and commodities that

[111] Marx, *Gundrisse: Foundations of a Critique of Political Economy,* New York: Penguin, 1973, p. 520.
[112] Palloix, "The Internationalisation of Capital and the Circuit of Social Capital," p. 76.
[113] Marx, *Capital II*, p. 742.

have not yet been sold.[114] This represents private production without the control of private property.[115] In this way, what the creditor or the speculator risks is "social property, not his own,"[116] While finance can be a means to purchase goods in advance, this is not its social form. Rather, finance is a means to combining capitals together and exerting control over social property.

The credit system then creates additional claims on existing assets, leading to the gradual concentration of fictitious capital. Since this concentration of fictitious capital cannot continue ceaselessly, it needs to be endorsed by profits in the production process in order to be realised. Within the Marxian framework, this can only occur through further exploitation of labour *via* wages reduction, the lengthening of working hours, and dispossession.[117]

This disciplining aspect of money and finance not only affects labour, but also impinges on individual capitalists. The financial system can be used "to impose the will of the capitalist class as a collectivity upon individual capitalists" by requiring a certain pace and level of profitability.[118] This, in turn, sets the criteria of profitability that individual capitalists and labour have to attain in order to reproduce themselves as a class. In this way, the socialisation of capital in the financial system "is fundamentally about compulsion and command: capitalists who cannot turn their products into cash go

[114] Harvey, *Limits to Capital*, p. 406.
[115] Marx, *Capital III,* p. 519
[116] Ibid., p. 570.
[117] David Harvey, drawing on Rosa Luxemburg's work, distinguishes between expanded reproduction and accumulation through dispossession and argues that the latter has become the dominant form of accumulation: "On the one hand, the release of low-cost assets provided vast fields for the absorption of surplus capitals. On the other, it provided a means to visit the costs of devaluation of surplus capitals upon the weakest and most vulnerable territories and populations." David Harvey, *The New Imperialism*, New York: Oxford University Press, 2003, pp. 184-5.
[118] Harvey, *Limits to Capital*, p. 412.

under (or in these more indulgent days, file for reorganization), and workers who can't turn their labor into cash will starve."[119] In this context, the extraction of further surplus value is not enough for the continued existence of capital and labour in the context of the international expansion of capitalism. As Dick Bryan argues:

> [I]n a global environment of competition, where all countries pursue productivity increases, simply increasing industry productivity does not itself lead to higher profitability (and hence wages and employment). With all countries pursuing productivity growth as the path to higher incomes, the productivity bar keeps being raised.[120]

In other words, capital and labour have to comply with the norm of profitability set by the financial system by increasing labour-time, reducing wages and cutting costs faster than in other countries. Thus, the international financial system sets a norm of profitability that provides the basis for comparing the performance of different capitals and labour process across space and time. More specifically, it establishes the rate of return that firms have to attain in order to be able to pay financial loans, sell their stocks, and remain profitable. This, in turn, ultimately relies on the capacities of firms to cut labour costs. This concept of finance as a disciplining form of capitalist social relations can then explain why money, despite being owned by a few, cannot be controlled by those few hands since their money is dispersed through varied mechanisms that operate independently of the owners.

Also, by considering finance as a social form through which capital moves internationally and crosses individual capitals, it is possible to understand how finance

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[119] Henwood, *Wall Street*, p. 231.

[120] Dick Bryan, "National Competitiveness and the Subordination of Labour: An Australian Policy Study," *Labour & Industry*, 11: 2, 2000.

attempts to overcome territoriality. More specifically, despite an individual capital's spatial constraints for its realisation and/or its reproduction, it remains internationalised through this amalgamation and crossing with other capitals, providing continuity to the process of capital accumulation.

Still, a contradiction surfaces from the inherent spatial dimension of capitalism - that is, capital's needs to accelerate the pace of accumulation and finance's attempts to overcome territoriality: "While capital must on one side tear down every spatial barrier of intercourse, i.e. to exchange and conquer the whole earth for its market, it strives to annihilate this space with time."[121] Marx argues that such annihilation does not refer to the destruction of space *per se*, but rather capitalism relies on the production of space rather than on production processes in space.[122] In other words, capitalism depends on the configuration of space to accelerate the turnover of capital – that is, the time it takes for labour and nature to transform into commodities and commodities into money. As such, this contradictory process between the need to accelerate the turnover of capital and the territorialisation of capitalist social relations is temporarily solved through the constant reorganisation of space. Marx observed that "annihilation of space through time" is a historical requirement for capital and regarded time and space configurations as important aspects of capitalism.

In Marx's view, space is neither static and ahistorical, nor a passive locus of social relations. Rather, space and geography are considered constitutive elements of capitalist social practices. The roles of production and money in the crossing of capital show that

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[121] Marx, *Gundrisse: Foundations of a Critique of Political Economy*, p. 539.
[122] Henri Lefebvre, *The Production of Space*, Cambridge: Blackwell, 1999, p. 219.

"particular places of production – as both class relations and state forms – are always implicated in a wider set of social relations, exchange flows, and competitive imperatives."[123] The international movement of capital depends on the spatial reproduction and expansion of the production process and capitalist social relations, which sustain the circuit of capital and assist to realise money and future claims over ownership within the nation-state.

State and the Internationalisation of Capital

The theoretical and political tasks, then, are to understand how the globality of capital and the nationality of regulation co-exist to sustain the global accumulation. In this respect, Lefebvre raises an important question:

> How does this space, which we have described as at once homogenous and broken up, maintain itself in view of the formal irreconcilability of these two characteristics? How can two such properties, 'incompatible' from the logical point of view, be said to enter into association with one another and constitute a 'whole' which not only does not disintegrate but even aids in the deployment of strategies?[124]

This relationship between the homogeneity of global accumulation and the nationality of its regulation can only be understood as a contradictory one. This cannot be grasped through a Cartesian logic which sees these scales as locations of coherence and neutrality whose malfunctioning is due to the lack of congruity.[125] On the contrary, the question

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[123] Albo, "The Old and New Economics of Imperialism," p. 101.

[124] Lefebvre, *The Production of Space*, p. 320.

[125] This is often portrayed in neo-Weberian views that advocate the construction of a cosmopolitan democracy. David Held argues that changes in the development of international law have placed individuals, governments, and non-governmental organisations under new systems of legal regulation. For this reason, Held suggests the need to create global regimes and institutions to cope with these transformations to handle the mismatch between territorially bounded democratic communities and territorially unbounded authority. See: David Held, *Democracy and the Global Order. From the Modern State to Cosmopolitan Governance,* Cambridge: Polity Press, 1995.

posed above requires a dialectical thinking to understand the contradictions of the internationality of accumulation and the nationality of state regulation. The notion of contradictions does not refer to inconsistency or incongruity. Rather, a contradiction, in its dialectical sense, means that "history unfolds *via* the opposition between forces that sustain accumulation." [126]

That said, the process of overcoming space to accelerate the movement of capital depends precisely on the (re)configuration of spatial structures. Thus, state territoriality matters in the expansion of international accumulation. As such, economic activities are not void of a social and spatial dimension, which is mainly the nation-state. As Tsoukalas points out: "Even if capital might be controlled in the ether, it must be accumulated on earth."[127]

The state plays a central role in the territorialisation of capital, the mobility of money, and the process of uneven development. First, the reproduction of capital requires the state to secure the conditions where production and reproduction can take place advantageously in a national space. Thus the territorial organisation of the state becomes the space where the dynamics of capital reproduction and its political expression are worked out. Indeed, economic deregulation, labour fragmentation, and profit maximisation are guaranteed through the nation-state's regulatory framework and its institutional, territorial, and legal cohesion. In this way, the conditions that reproduce capitalism at the international scale depend on national states to ensure new forms of

[126] Bryan, *The Chase Across the Globe,* p. 4.
[127] Konstantine Tsoukalas, "Globalisation and the Executive Committee: Reflections on the Contemporary Capitalist State," in Leo Panitch & Colin Leys (eds.), *Socialist Register 1999: Global Capitalism vs. Democracy,* London: Merlin Press 1999, p. 58.

accumulation and class exploitation.[128] The notion of state territoriality refers to the ways in which space is appropriated, experienced, and represented by different classes through the nation-state to reproduce or hinder the process of capital accumulation. The nation-state is not dissolved by the internationalisation of capital, but rather, as Nicos Poulantzas argues:

> [T]he internationalization of capital neither suppresses nor bypasses the nation-states either in the direction of peaceful integration of capitals "above" the state level… or in the direction of their extinction by the American super-state, as if American capital purely and simply directed the other imperialist bourgeoisies.[129]

Second, while finance allows for the bridging between different moments of capital, claims over future production cannot continue circulating indefinitely without an actual basis of production. As such, finance cannot detach from its monetary basis, actual production, or social labour. Finance is forced to relate back to the monetary basis as different economic activities need to be realised in some currency.[130] Thus, international exchange occurs through fluctuating exchange ratios that strive to sustain the worthiness of money. Still, these exchange ratios are established in different forms of money, which are secured by the state. Hence, money encounters social barriers despite its circulation around the world. Geographical differences in the form of the nation-state can also shape investors' decisions according to their preferences in terms of national money and state regulations, particularly the state's influence in determining interest and exchange rate differentials.[131] In this way, the role of space differentiation in the form of

[128] Tsoukalas, "Globalisation and the Executive Committee," p. 67.
[129] Nicos Poulantzas, *Classes in Contemporary Capitalism*, London: New Left Books, 1974, p. 73.
[130] Harvey, *Limits to Capital*, p. 293.
[131] Dick Bryan, "Global Accumulation and Accounting for National Economic Identity," *Review of Radical Political Economics*, 33: 1, 2001, p. 60.

exchange and interest rates and state regulations in financial markets show that the territoriality of nation-states is integral to the globality of accumulation.

Third, capitalism's reliance on a constant reconfiguration of space is driven by capitalist competition, which ultimately (re)produces spatial uneven development.[132] This competitive struggle consists of the search for new markets, cheaper labour, and abundant and inexpensive raw materials that in turn rely in the deepening and expansion of capitalist social relations spatially. In order to extract more surplus labour and exploit nature, capital needs to alienate workers from their own labour and their relationship to nature. As mentioned previously, this precondition relies on the reproduction of capitalist social relations and a fixed institutional framework situated within a legally-defined territory of the nation-state.[133] Capitalism, more specifically, needs a complex infrastructure of fixed capital and immovable territorial organisation to reproduce capitalist social relations and accelerate the turnover of capital. These developments respond to the needs of capitalists to minimise costs and turnover of commodities under conditions of inter-industrial linkages, to create a social division of labour, and to gain access to raw materials, labour supplies, and final consumer markets.

The state then plays a central role in the process of capital territorialisation since it its through state regulations that conditions of profitability can be temporarily guaranteed within a given socio-spatial fix. The state implements spatial strategies to divide, territorialise, and hierarchise social relations at and across different geographical scales. In this way, the state can reorganise space through policies that regulate economic

[132] Panitch and Gindin, "Global Capitalism and the American Empire," p. 6.
[133] Albo, "The Old and New Economics of Imperialism," p. 102.

restructuring and industrial growth through the state's ability to channel money flows into infrastructure investments, urbanization, and investment-promotion programs. This is derived from the state's ability to allocate tax revenues and mobilise financing based on credit for infrastructure, and to control different spatial configurations through state legal regulations.

Once value is produced, it can circulate and come to rest in another spatial fix, namely a city, region, or nation-state. Money does not have to be reinvested in the locations where it was originally appropriated. Firms may invest in competing factories elsewhere or new sectors of the economy. In this way, a process of deterritorialisation of capital occurs through financial flows and investment mobility when money moves in order to reallocate investment and production.[134] As capitals attempt to suspend the contradictions they face to assure their own future profitability, cheaper labour and natural resources elsewhere are exploited and trade links expanded to obtain cheaper sources overseas. The state re-organises space *via* state policies to offer more advantageous conditions for capital profitability in order to territorialise capital again.

This process expresses the capitalist tendency of uneven development – that is, the capitalist tendency to simultaneously homogenise space and produce differences. On the one hand, capitalism requires the creation of institutional infrastructures to give an internal coherence to production processes, consumption patterns, and realisation of financial capital everywhere. This might entail the destruction of nature and

[134] See: See Neil Brenner, "Global, Fragmented , Hierarchical: Henri Lefebvre's Geographies of Globalization," *Public Culture,* 10: 1, 1997; Neil Brenner, "Between Fixity and Motion: Accumulation, Territorial Organization and Historical Geography of Spatial Scales," *Environment and Planning D: Society and Space*, 16: 5, 1998.

disintegration of the existing social relations to homogenise space.[135] On the other hand, this competitive imperative to homogenise space puts pressures on state policies and its role in the organisation of space to formulate policies that allow for more favourable investment conditions – that is the re-territorialisation of capital, fragmenting the national economic space, and producing uneven development.

This shows how accumulation is a contradiction-ridden process proceeding in a geographically differentiated context. This contradiction assumes a territorial form and its resulting conflicts take spatial expressions, particularly in the nation-state.[136] In other words, the process of uneven development is "also always differentiated by particular strategies of social actors, mediating institutions, and political conflicts."[137] As Harvey has written: "The tension between free geographic mobility and organized reproduction processes within a confined territory exists for both capitalists and labourers alike. And how that tension is resolved for either depends crucially on the state of class struggle between them."[138]

The State, the Power Bloc, and the Internal Bourgeoisie

While it is important to grasp the inner workings of the spatial dimension of the capitalist system and its articulation to the state, this cannot be done apart from the social agencies that undertake decisions, implement strategies, and command capital – the state and labour-power. Otherwise, the processes through which finance and accumulation are constituted are portrayed as neutral and depoliticised processes.

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[135] David Harvey, *Spaces of Capital,* Edinburgh: Edinburgh University Press, 2001, p. 328.
[136] Harvey, *Limits to Capital*, p. 404.
[137] Greg Albo, "Contesting the New Capitalism," in David Coates (ed.), *Varieties of Capitalism, Varieties of Approaches,* New York: Palgrave, 2005, p. 68.
[138] Harvey, *Limits to Capital*, p. 149.

In order to account for this social agency, it is necessary to draw a parallel between the globality of accumulation and the territoriality of states. Whereas exchange can occupy worldwide space, the production, reproduction, and realisation of capital are always localised in the nation-state. This comprises social conflict over working conditions, wealth distribution, and state policy. For this reason, financial markets then have social and political significance in national class struggle and hence entail power relations that extend beyond the dealings of finance. As Harvey notes, the reproduction of capital as a social relation is not only implicated in the moments of capital, but rather in the reproduction of social classes and the class struggles embedded in these moments.[139] This class struggle is then materialised politically within the state. The state encompasses a dialectical relationship between social conflict and the structural forms through which conflict is negotiated since "right from the beginning, the state marks out the field of struggles, including that of the relations of production... it stamps and codifies all forms of the social division of labour of social reality within the framework of a class divided society."[140]

The nation-state remains central in reproducing the dominant capitalist social relations within the national social formation and guarantying the expansion of the circuit of social capital as whole. This shows that the territoriality of the nation-state does not disappear. The state's role in capitalism, however, can be transformed according to the different class struggle that is played out within the 'national' social formation.

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[139] Harvey, *Limits to Capital*, p. 97.
[140] Nicos Poulantzas, *State, Power, Socialism*, London: Verso, 1980, p. 114.

The changing role of the state indicates that the state is neither a passive entity nor an institution with power of its own in the Weberian sense. Rather, it is a site of struggle where class power is institutionally materialised. As such, the nation-state is the locus where capital organises politically and is reproduced socially. Poulantzas notes that social classes can only exist politically by way of their relationship with the state.[141] This articulation of classes to and within the state manifests itself within what Poulantzas calls the power bloc.

The power bloc, according to Poulantzas, is inherent in the capitalist form of the state since it is constituted by and through the capitalist class struggle. The power bloc does not have a binary dimension since there is not a pre-determined single dominant class.[142] Instead, it comprises the several classes and class fractions in power. The power bloc expresses itself politically through the constitutions of venues of representation, such as political parties, and becomes a field of class struggles that constitutes a contradictory political unity of social classes. The opposition between the interests of these classes is continuously present since these interests retain their different and antagonist interests.[143] The state has to simultaneously produce the conditions necessary for a cohesive capitalist class and secure the consent of subordinate classes to capital's rule. This contradictory process, Poulantzas argues, makes it difficult to define the state as a monolithic institution "without cracks."[144] As a result, the ways in which internationalisation is mediated by political boundaries is not determined by a particular logic. Rather, it

[141] Poulantzas, *Classes in Contemporary Capitalism*, p. 25.
[142] Nicos Poulantzas, *Poder Político y Clases Sociales en El Estado Capitalista*, Mexico: Siglo XXI, 1978, pp. 295-305.
[143] Poulantzas, *Poder Político y Clases Sociales en El Estado Capitalista*, p. 139.
[144] Ibid., p. 132.

depends on the historical specificity of the nation-state and the class struggle of a particular social formation and its expression through the power bloc. This suggests that state policies are never predetermined. Instead, class conflict shapes state policy and the state mediation of this antagonism can affect the ways in which individual capitals are articulated to international accumulation.

It remains important, however, to note that not all classes within the power bloc are internationally-oriented. While there is a particular tendency of capitalism to expand internationally, this process does not take place mechanically or uniformly. There are specific interests within the bourgeoisie that are influential in shaping state policy to provide the conditions for the international expansion of the capital relation. Recent internationalisation has made it rather difficult to explain and define the bourgeoisie within the power bloc, its origins, and its influence in the nation-state. The discussion of the bourgeoisie, particularly in the so-called peripheral economies, has often been dominated by approaches of national *versus* foreign capital and the *comprador* bourgeoisie. On the one hand, the *comprador* bourgeoisie is regarded as a part of the capitalist class that does not have its own base for capital accumulation in the social formation and serves as a simple intermediary of foreign capital. On the other hand, the concept of national capital, as opposed to foreign capital, is based on the notion that the former is enclosed in a national space and confined to the home market. In either case, foreign capital is seen as an external imposition.

Poulantzas suggests that social classes, including the bourgeoisie, take a national form. The bourgeoisie, however, is not confined to the domestic market. Rather, it is

"implicated by multiple ties of dependence with the international division of labour and capital concentration."[145] This, in turn, points at the pivotal role of an interior bourgeoisie located in a national economy that has articulated itself to the processes of the internationalisation of capital. This leads to a conceptualisation of the bourgeoisie that is not limited to the dichotomous interpretations of 'foreign' *versus* 'domestic,' but rather it comprises the articulation of the nation-state and the process of internationalisation as they express themselves as social classes.

In this way, Poulantzas's definition of internal bourgeoisie conceptualises 'global' capital as a faction within the internal/national class structure. As such, the internal bourgeoisie, because of its articulation to international accumulation, is informed by international criteria of profitability, such as investment strategies at home and abroad, productivity rates, and levels of economic return. This suggests that the internal bourgeoisie, as part of the class struggle that takes place within the state, brings to the state agenda its requirements to secure its own patterns of accumulation and returns.

Also, foreign capital, despite its global label and origins, can integrate itself into local territories and patterns of economic reproduction. This entails accommodation of the capitalist class, regardless of its national origins, to domestic regulations and economic situation brought about by the class struggle of the social formation that it permeates. This, of course, deepens capitalism within the social formation where capitals invest – thus, further entrenching the social relations that sustain the internal bourgeoisie within the nation-state.

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[145] Poulantzas, *Classes in Contemporary Capitalism*, p. 72.

The internal bourgeoisie retains or exhibits its own features and heterogeneity. This derives from the historical and social conditions that correspond to the national social formation where this bourgeoisie originated and where it maintains the dominant social relations that constitute its wealth.[146] The interior bourgeoisie is also comprised of internal contradictions with differing interests that the state mediates.[147]

Although the internal bourgeoisie, and the power bloc as a whole, might influence national policy in order to maximise profits, the state intervenes in the national space to mediate the opposing interests within it. In this way, conflicting interests are expressed in the internal contradictions with respect to state intervention. State intervention reveals the heterogeneity, and at times opposing strategies, within the state that reproduce the power bloc.

This mediation of class interests has become increasingly difficult because of the internationalisation of capital as antagonisms within the power bloc become internationalised. In this respect, Harvey notes that while much of the state power is located at the national level, there remains the problem of integrating local and global requirements of accumulation.[148] As a result, the political unity of the power bloc is constantly jeorpardised even as the power of the nation-state depends, crucially, on the unity and cohesion of the power bloc constituted and represented by the state. This, however, has not led to a dismantling of the state and the power bloc, but rather to a restructuring of the state apparatus and the reorganisation of class relations within the

[146] Poulantzas, *Classes in Contemporary Capitalism*, pp. 60, 72.
[147] Ibid., p. 96.
[148] Harvey, *Limits to Capital*, p. 423.

nation-state in order to deal with the intensification of class contradictions in the context of internationalisation and neoliberalism.

The Restructuring of the State and the Internationalisation of Capital

As a result of class conflict, several mechanisms have emerged within the apparatuses of the nation-state in order to cope with internal contradictions and the international requirements of accumulation. According to Poulantzas, the internationalisation of capital has led to a shift in the economic boundaries between the state and the economic sphere, even though their separation has not been abolished.[149] The persistence of this separation of the 'economic' and the 'political' realms of life under capitalism has then allowed the reorganisation of the state apparatus in such a way that economic management is insulated from popular pressures.

Ellen Wood argues that the separation of the economic from the political sphere is a particular characteristic of capitalism since the immediate imperative is economic need. This imperative forces the worker, who is already alienated from the means of production, to transfer surplus labour to the capitalist. Meanwhile, exploitation no longer depends directly on relations of coercion or political dependence on the state, even though the coercive force of the state is ultimately necessary to reproduce capitalist social relations. These relations of exploitation in the 'economic' sphere take the form of formally free and equal individuals that interact in even conditions in the market and have equality before the law.[150] This separation between the 'economic' and the 'political'

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[149] Poulantzas, *Classes in Contemporary Capitalism*, p. 168.
[150] Ellen M. Wood, *Democracy Against Capitalism*, Cambridge: Cambridge University Press, 1995, pp. 28-9.

realms and their apparent equality before the law, Wood argues, have assisted capital in the management of labour power and money. Labour power and money have been, in turn, treated by the state as purely economic phenomena, depoliticising these spheres of society.[151]

While depolitisation of economic management has become a key change in the state apparatus, the internationalisation of capital has also made even more necessary the economic intervention of the state to secure the extended reproduction of capital internationally. This entails a transformation in the economic intervention of the state, which has been linked to a shift of power from the Legislative to the Executive branch. This reflects the realignment of the state in relation to the power bloc, and the "isolation and concealment" of capitalist social relations.[152] Poulantzas observed that the legislative power, through the universal suffrage that sustains it, posed a threat to the dominant classes during the 1970s.[153] For this reason, he noted that the Executive branch tended to remain insulated from popular pressures since its existence did not rely extensively on the popular vote.

Recently, this insulation of the Executive branch has intensified because of the increasing social discontent caused by neoliberal economic restructuring. This has entailed a deeper reorganisation of the state apparatus in which agencies dealing with economic intervention have expanded their role in policy-making and become isolated

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[151] See: Peter Burnham, "The Politics of Economic Management in the 1990s."
[152] Poulantzas, *Poder Político y Clases Sociales en El Estado Capitalista*, p. 409.
[153] Ibid., p. 410.

from democratic structures through an increase in their institutional autonomy.[154] Thus, the increasing concentration of power in the Executive branch has resulted in a governing strategy that contains class struggle, ensure accumulation, and make economic decision-making more remote to the process of democratic participation and accountability.

This has been particularly reflected in the institutional transformations of the central bank independence and the primacy of price stability in the state agenda. The central bank is pivotal in the politics of money management since it sets the conditions under which other currencies are convertible into its own money and influences the movements of national interest rates.

These central banking mechanisms have a wide effect over other policies and throughout the state apparatus particularly over wages and public spending. Still, policies of money management and inflation targeting do not take a homogeneous form across national social formations. Rather, the particular social contestation and the institutional mediation embedded in the nation-state determine the ways in which money management policies are formulated and implemented.[155]

Mechanisms to maintain price stability are often related to downward pressures on wages and constraints on public spending. These wage and public spending limitations operate to make payments on public debt while preventing the circulation of exceeding quantities of government money in the economy. Exchange rate stability, on the other hand, relies on a slow increase of nominal GDP through price inflation. This guarantees

[154] Greg Albo, "Neoliberalism, the State and the Left: A Canadian Perspective," *Monthly Review*, 54:1, 2002, p. 48.
[155] Albo, "Contesting the New Capitalism," p. 75.

profits in the country while keeping 'real' interest rates relatively stable and yet attractive for investment in the currency.[156] Such policies rely on assumptions that see inflation as a result of the excess of money wages and workers' consumption. Capitalists, as suggested by neoclassical economics, have a high tendency to save their income rather than consume it. Workers, on the other hand, tend to consume all their income.[157]

This, however, is misleading since excess of money and the economy and prices are mostly determined by financial markets. Folkerts Landau argues that "an increase in the mobility of international capital flows or an increase in the substitutability of financial assets across currencies attributable to the growth of external financial markets may exert inflationary pressures" since the proportion of capital flows are larger than the amount of monetary aggregate that authorities can 'sterilise.'[158]

While assumptions of the strategies to control inflation are problematic in theory and practice, it remains the main rationale behind the politics of money management. Anti-inflationary policies have consequences on workers' purchasing power, consumption and access to credit. This, in turn, has the potential of generating social discontent and political contestations to the state's inflation-targeting policies. As Poulantzas notes, the state apparatus has to be restructured to internationalise capital and

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[156] Shimshon Bichler and Jonathan Nitzan, "Dominant Capital and the New Wars," *Journal of World-Systems Research*, 10: 2, 2004, p. 294.

[157] Jonathan Nitzan and Shimshon Bichler, *The Global Political Economy of Israel*, London: Pluto Press, 2002, p. 153.

[158] A central bank can use domestic currency to buy assets from a commercial bank, creating the money through crediting the clearing account of the commercial bank. There is therefore a corresponding increase in both the assets and liabilities of the central bank. When this does not occur, the central bank needs to neutralise, or sterilise, the monetary consequences. On the asset side, if the central bank holds government debt on its books, it can be sold outright or used in repurchase arrangements; or if it has loans outstanding to commercial banks, they can be recalled. On the liability side, the central bank can issue its own debt or simply borrow from the banks. David Folkerts Landau, "Potential to External Financial Markets to Create Money, Credit and Inflation," *IMF Staff Papers*, 29, 1982, p. 101.

contain the class struggle within the social formation. The alternative has then become to concentrate power into the Executive branch, including granting the central bank greater influence over economic policy-making, and transforming central banking into a technical and depoliticised function of the state, symbolised by the so-called central bank independence. As such, state restructuring in the context of capital internationalisation has focused on the central bank's adoption of a rules-based approach to monetary policy and institutional autonomy.

The justification for this rules-based approach is that institutional objectives, such as low inflation, prevent political and partisan interests from intervening in the economic agenda. Thus, money management cannot be used for private interests. Here, price and currency stability appears to be externally imposed, and this, in turn, removes the political character of monetary policy. This economic rationalist approach to public policy has a parallel in Weberian models of public policy. Weberian perspectives on public policy argue that organisations might be uncertain about how to manage their own resources and need to remain legitimate. Thus, the institutional strategy to achieve certainty and guarantee the survival of the organization and legitimacy is rationality.[159] This is defined as the setting of objective organisational goals which can be attained through goal-oriented strategies such as the protection of the organisation's mission, the expansion of control over personnel, and the development of expertise. In this context, institutional survival is also assured through institutional autonomy.

[159] Michael K. Brown y Steven P. Erie, "Poder y Administración: Paradigmas Alternativos para el Análisis de la Autonomía Burocrática," en Oscar Ozlak (ed.), *Teoría de la Burocracias Estatal: Enfoques Críticos,* Buenos Aires: Paidos, 1984, p. 171.

Thus, Weberian notions of autonomy along with economic rationalist conceptions of inflation often converge around the idea that government spending, outside the hands of neutral policy-makers, is wasteful and causes inflation. Governments, it is assumed, tend to monetise their deficit, resulting in the circulation of more money and hence high inflation.[160] This can only be remedied by giving authority to policy-makers that can be trusted to choose policies that are not inflationary. Central bankers are seen as social agents less constrained to pursue anti-inflationary measures.

These assumptions regarding the neutrality of public economic management remain questionable for several reasons. First, rules-based and autonomy approaches to central banking conceal the fact that the state money management functions are not entirely neutral since the mechanisms to secure low inflation are left to the discretion of the monetary authorities. Second, assumptions of autonomy based on the central banks' need to survive render invisible questions about the overwhelming power of the central bank over other parts of the state apparatus. In other words, the question is not how the central bank can guarantee its continued existence, but rather why the central bank has more power than other state agencies. Third, the notion that money issues need to be handled by the neutral expertise of bureaucrats such as central bankers presupposes that the trajectory of economic policy cannot be affected by the existing social inequalities, and the struggle among parties in the political arena.[161] This ignores that central bank independence might facilitate the involvement of dominant interests while precluding the participation of subordinated classes from economic-policy making. Fourth, the need to

[160] Nitzan and Bichler, *The Global Political Economy of Israel*, pp. 146-7.
[161] Brown y Erie, "Poder y Administración," p. 184.

depoliticise central banking is also based on the idea that the central bank is the sole source of money supply. Yet, this is problematic because state intervention is only 'one' determinant of money supply among many within capitalism. Thus, inflationary pressures do not only originate with the decisions of central bank, but also with those of financial managers in the private sector. Financial managers are able to disrupt the central bank's inflation strategy "by generating new sources of endogenous money growth, particularly as reserve requirements are reduced, credit controls relaxed, and multiple forms of credit-money expand."[162]

Such rationalisation of economic policy reduces political participation to administrative functions of the bureaucracy. Within institutional autonomy and goal-oriented approaches to central banking, the reorganisation of the state apparatus into autonomous institutions entails the isolation of economic policy from public contestation.[163] This shows that a strategy of depolitisation is in fact a highly political mechanism to limit public participation into economic and political matters.

Steven Kettell argues that this strategy channels social discontent away from monetary policy and less menacing issues concerned only with separate 'economic' or 'political' issues such as electoral representation.[164] Also, this strategy of depolitisation of economic decision-making provides institutional rules to lock-in policies and conditions the expectations of capital and labour. In this way, economic policies become less subjected to changes in party politics and societal demands. Central bank

[162] Matthew Watson, "The Institutional Paradoxes of Monetary Orthodoxy: Reflections on the Political Economy of Central Bank Independence," *Review of International Political Economy*, 9:1, 2002, p. 188.
[163] Brown y Erie, "Poder y Administración," p. 178.
[164] Steven Kettell, *The Political Economy of Exchange Rate Policy-Making*, New York: Palgrave, 2004, p. 26.

independence, therefore, allows for the insulation of economic decision-making that affects wages and public spending from popular pressures. This autonomy, simultaneously and paradoxically, ensures expansion of the state's control over economic matters.

The increasing importance of autonomy within the state apparatus suggests a decline of the role of political parties in relation to the concentration of political and economic power of the Executive branch. In this context, the internal conflict reflected in political parties, as Tsoukalas notes, might become merely 'theatrical' since political conflict is only focused on superficial and secondary discussions that do not address class issues and do not solve the political, social and economic problems of their constituencies. As a result, political parties and political discourse are "suffering an increasing loss of substance."[165]

Conclusion

In the general debate of internationalisation and finance, the state is often left unproblematised. On the one hand, the state is seen as subordinate to the global movement of capital. On the other, the state is depicted as an *a priori* entity that in aggregation constitutes the 'international.' In both cases, the state's national form is assumed rather than historically analysed. It remains, therefore, unclear whether state restructuring and the allocation of financial investment are due to particular local mediations of the nation-state, to the ineluctable force of global finance, or to the tensions between both.

[165] Tsoukalas, "Globalisation and the Executive Committee," p. 69.

By considering money, state territoriality, and class conflict, one can acknowledge the transformations of the 'political,' particularly the nation-state, as an integral part of international accumulation. In this way, international accumulation can be seen in the context of transforming spatial, local, and national processes as well as shifting societal power relations and *vice versa*. Overall, the relationship between the state and accumulation is a contradictory one. The space where capital circulates exists in contradiction with the space where it is secured and reproduced by the territoriality of the state.

An analysis of the relationship between globality and territoriality can shed light on the historical development and consolidation of capitalist social relations in Mexico, the forms of state economic intervention, and the role of the financial system in linking the capital relation with the Mexican nation-state and international accumulation. These are the themes to be explored in the following chapters, particularly the ways in which the internationalisation of capital in the period of neoliberalism has transformed the territoriality and the form of the Mexican state and politics.

Chapter 3

The Development of the Mexican Financial System

In order to understand the particularities of the Mexican economy and its articulation to international accumulation through finance, it is necessary to account for the developmental models that guided state policy before and during the debt crisis of 1982. Several accounts of the construction of the Mexican economy emphasise the role of industrial development in this process. Banking and finance, however, are seen as external to the societal conflict and economic processes occurring in the country. This chapter contends that the role of finance in the Mexican economy has been integral to the expansion of capitalist social relations in Mexico and the economy's integration to international accumulation. The role of finance was fundamental in both the implementation and the demise of import substitution industrialisation (ISI) and the further internationalisation of the Mexican economy.

The chapter first presents several analyses within the Mexican literature that offer varied explanations of the ISI model. I also discuss the contributions and the shortcomings of these approaches. Second, I offer a historical overview of the Mexican economy, placing emphasis on state economic intervention and the financial system throughout the twentieth century. Third, the chapter historically situates the nature of Mexican finance in the ISI period in order to understand the recent transformations of the role of state territoriality in reproducing finance and Mexican capitalism.

ISI, Crisis, and Finance in Mexico

The failure of the ISI model and the subsequent 1982 debt crisis instigated several debates amongst Mexican analysts regarding the nature of these changes and the role of the state within. The economic rationalist debate focused on state policy mismanagement and its effects on markets in Mexico. The debate emphasised that the prevalence of the ISI was accompanied by extensive foreign borrowing. According to this view, borrowed funds were not efficiently used in promoting industrialisation, and hence increased Mexico's external debt and debt service ratios.[1] Pedro Aspe Armella argued that policy mismanagement also originated from economic protectionism. The ISI model prevented competition since public monopolies, in particular, created conditions of high prices and slow economic growth.[2] In terms of the financial structure, Aspe indicated that the Mexican financial system was too rigid to function in times of high inflation.[3] Guillermo Ortiz suggested that financial savings were discouraged during the 1970s, lessening the availability of the credit necessary to fund private investment.[4] Uncertainty of real interest rates had negative effects on investment output and overvaluation of the peso brought about a current account deficit.[5] This, in turn, 'repressed' the financial system, preventing a "rising volume of profits and financial savings."[6]

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[1] Bela Balassa, "Adjusting to External Shocks: The Newly Industrializing Developing Economies in 1974-76 and 1979-81," *World Bank Reprint Series*, 355, 1985, p. 135.
[2] Pedro Aspe Armella, *Economic Transformation: The Mexican Way*, Cambridge: MIT Press, 1993, p. 11.
[3] For instance, interest rates did not respond to high inflation, leading to capital flight. Ibid., pp. 67-8.
[4] Guillermo Ortiz Martínez, *Capital Accumulation and Economic Growth: A Financial Perspective on Mexico,* London: Garland Publishing, 1984, p. 163.
[5] Ana María Menéndez, et al., "Mexico: Five Years After the Crisis," Paper presented at the ABCDE *World Bank Conference*, Washington: 2000, p. 16; Balassa, "Adjusting to External Shocks," p. 128. See also: Ho Khor and Liliana Rojas Suárez, "Interest Rates in Mexico: the Role of Exchange Rate Expectations and International Creditworthiness," *International Monetary Fund Staff Papers*, 38: 4, 1991.
[6] Ortiz Martínez, *Capital Accumulation and Economic Growth*, p. 184.

The second debate stressed imbalances among economic sectors, the lack of technology in the industrialisation process, and the role of speculative finance in distorting production in the ISI.[7] This approach argued that the Mexican state only promoted industrialisation in durable consumer goods sectors. Carlos Pereyra suggested that these goods had a small market, affordable only to the capitalist elites.[8] Workers and peasants, in contrast, spent their earnings on non-durable goods, particularly food.[9] According to David Barkin and Gustavo Esteva, this limited market, in the context of protected industries, led to a general increase in prices. The lack of competition generated by the ISI led to rising prices, which made it more difficult for middle and working classes to access durable consumer products.[10] The low demand for products then caused production bottlenecks and conditions of overproduction due to the inability of firms to realise their output.

Rolando Cordera and Carlos Tello also noted that the Mexican state and the private sector did not invest in technological equipment. As a result, these merchandises had to be imported to sustain industrialisation.[11] The rising costs of imports and the

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[7] It is worth noting that the Mexican debate on sectoral imbalances and the speculative character of the economy, to some extent, draws on the work of the structuralist school, whose main proponent was Raul Prebisch. According to Prebisch, the inflow of foreign loans increases the amount of currency and credit, expanding the money supply. This is accompanied by growth based on private speculation and fiscal irresponsibility. Under these circumstances, the balance of payments deficit worsens because of the disproportionate growth of imports and the increase in expenses on services and debt interests. Adolfo Gurrieri, "The Young Prebisch," *CEPAL Review*, 71, 2001, p. 75.
[8] See also: David Barkin y Gustavo Esteva, *Inflación y Democracia: El Caso de México*, Mexico: Siglo XXI, 1979, p. 75; Esthela Gutierrez Garza, "De la Relación Salarial a la Flexibilidad del Trabajo," en Esthela Gutierrez Garza (ed.), *Los Límites Financieros del Estado en América Latina. El Caso de México*, Mexico: UNAM, 1998.
[9] Carlos Pereyra, "Mexico: Los Límites del Reformismo," en Rolando Cordera (ed.), *Desarrollo y Crisis de la Economía Mexicana*, Mexico: Fondo de Cultura Económica, 1985, p. 356.
[10] David Barkin y Gustavo Esteva, *Inflación y Democracia*, pp. 75-6.
[11] Rolando Cordera y Carlos Tello, *México: La Disputa por la Nación*, Mexico: Siglo XXI, 1984, pp. 58-9; Jose Blanco, "El Desarrollo de la Crisis en México," en Rolando Cordera (ed.), *Desarrollo y Crisis de la*

appreciation of the peso increased the price of Mexican exports. This created disequilibrium in the current account, which could only be sustained through foreign debt. When oil prices fell and international bank syndicates requested loan payments, the ISI model could no longer be upheld.[12]

Finance in this period was explained in terms of the lack of competition in the banking sector. The concentration of the financial system in a few banks allowed Mexican banking institutions to pay lower interest rates to savers and charge higher interest rates to borrowers.[13] Edwin Rodríguez and Teresa López González argued that the concentration of the banking sector also created the conditions for the channelling of resources towards financial speculation rather than productive investment, intensifying the existence of production bottlenecks and balance of trade problems.[14]

The third approach explained the ISI and the 1982 debt crisis in terms of the rigidities that emerged in the intensive regime of accumulation in Mexico. The Regulationist School considered that countries such as Mexico have gone through a period of peripheral Fordism. Alain Lipietz considered that economies such as Mexico remained peripheral because consumer markets were not fully developed, and labour, for the most part, was unskilled.[15] According to Angel Rivera Ríos, the Mexican economy was under a period of transition characterised by a shift from 'extensive' rural and

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Economía Mexicana. "Mexico: Fondo de Cultura Económica," 1985, p. 458; Teresa López González, *Fragilidad Financiera y Crecimiento Económico en México*, Mexico: Plaza y Valdés, 2001, p. 26.

[12] Cordera y Tello, *México: La Disputa por la Nación*, pp. 103-4.

[13] Barkin y Esteva, *Inflación y Democracia*, p. 83.

[14] Edwin Rodríguez, "El Capital Financiero, el Gobierno y la Nacionalización de la Banca Privada Mexicana," en Alberto Ruiz de la Peña (ed.), *Banca y Crisis del Sistema*, Mexico: Pueblo Nuevo, 1983, pp. 56-7; López González, *Fragilidad Financiera*, p. 16.

[15] Alain Lipietz, *Miracles and Mirages: The Global Crisis of Fordism*, London: Verso, 1987, pp. 78-9; Edward McCaughan, "Mexico's Long Crisis: Towards New Regimes of Accumulation and Domination," *Latin American Perspectives*, 20: 3, 1993, p. 9.

household production to industrial production.[16] But this transition was characterised by low productivity outcomes in the industrial sector and a limited capacity for mass domestic consumption because of the poor living and labour conditions of Mexican workers and peasants. As such, peripheral Fordism in Mexico resulted in an accumulation process that relied heavily on lowering the wage costs of production and increasing foreign debt to finance capital expenditures. These limits eventually caused the breakdown of the regime.[17] The dynamics of overproduction and the profit crisis that occurred in industrialised countries, Edward McCaughan suggested, were not the causes of the crisis of peripheral Fordism in Mexico. Rather, the lack of effective demand, combined with the oil crisis and the resulting fiscal deficit of the Mexican state, were what brought about the breakdown of the regime.[18] This, according to the Regulationist school, occurred in a context where financial speculation channelled investment away from production, and the Mexican economy became even more dependent on the United States.[19]

The fourth debate sought to understand the ISI and the debt crisis as the result of the contradictions that originated from state monopoly capitalism in Mexico.[20] Alonso Aguilar, the main precursor of this school of thought in Mexico, argued that the Mexican

[16] Miguel Angel Rivera Ríos, *Crisis y Reorganización del Capitalismo Mexicano*, Mexico: ERA, 1986, p. 34.
[17] Jesús Lechuga Montenegro, "Acumulación y Regulación en la Economía Mexicana 1975-2000," *Problemas del Desarrollo*, 32: 125, 2001, p. 73.
[18] Rivera Ríos, *Crisis y Reorganización del Capitalismo Mexicano*, pp. 33-4.
[19] Ibid., pp. 38, 57.
[20] State monopoly capitalism refers to the concentration of economic activities in the hands of the state and a few firms. The lack of competition, along with the protectionist policies encouraged by the ISI model, gave the state and monopoly firms the power to increase prices, hence extracting more surplus value and increasing the rate of exploitation. Raúl Rojas Soriano, *Ensayos sobre la Acumulación de Capital en México*, Puebla: UBAP, 1983, p. 179.

state consolidated its capitalist character throughout the 1900s.[21] According to this perspective, the reproduction of capitalism in Mexico relied on the extensive state intervention to foster private and public monopolies. The Mexican state provided the conditions for capitalist reproduction through state-owned enterprises and the consolidation of the monopolic organisation of the banking system.[22] Bank monopolies, however, weakened state mechanisms to deal with capitalist contradictions, limited the valorisation process, and created instability in accumulation in Mexico.[23] In this process, the Mexican state was seen as having a relative autonomy from the capitalist class. At times, such autonomy allowed the state to take decisions that opposed a certain faction of the ruling class, which, in the long run, promoted the reproduction of the capitalist class as a whole.[24]

Some of these analyses offer insightful contributions to the study of the Mexican economy, but they offer only a partial understanding of the relation between class struggle, the Mexican state, and finance in the implementation of the ISI model and the disciplining social relations in Mexico. The economic rationalist interpretation of the failure of the ISI and the 1982 debt crisis is based on assumptions of policy mismanagement. Economic mismanagement is seen as the result of financial 'repression,' economic protectionism, and the expansion of public monopolies.[25] This

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[21] Alonso Aguilar, *Estado, Capitalismo y Clase en el Poder en México*, Mexico: Nuestro Tiempo, 1983, p. 190.
[22] Raúl Rojas Soriano, *Ensayos sobre la Acumulación de Capital en México*, p. 178.
[23] Aguilar, *Estado, Capitalismo y Clase en el Poder en México*, p. 81; Rojas Soriano, *Ensayos sobre la Acumulación de Capital en México*, pp. 206-7.
[24] Aguilar, *Estado, Capitalismo y Clase en el Poder en México*, p. 215.
[25] See: Robert Looney, "Mechanisms of Mexican Economic Growth: The Role of Deteriorating Sources of Growth in the Current Economic Crisis," *Journal of Social, Political and Economic Studies,* 12, 1987.

approach overlooks the historical role of the Mexican state in sustaining the economy and providing profitable conditions to private firms (particularly during the 1970s). This is evident in this debate's two main assumptions. First, the economic rationalist approach argues that the Mexican government did not use oil revenues and foreign borrowing for prudent spending, but rather in excessive government expenditures, increasing both inflation and the budget deficit. Yet, the Mexican state employed most of this wealth in supporting private sector financial operations during the 1970s. Through foreign borrowing and oil exports, the state could subsidise private firms and sustain the value of the peso. Second, arguments of financial repression ignore other policies that functioned to the advantage of private firms, particularly the Mexican banks. The issuing of public debt at profitable rates and state reforms that promoted financial concentration in the 1970s favoured the position of those private firms closely linked to the Mexican financial system.

In contrast, a discussion of production and consumption imbalances among economic sectors and the lack of domestic-produced technology provides an explanation of the internal functioning of the process of industrialisation in Mexico and the role of state policy in it. These analyses, however, only account for inconsistencies between production and consumption, and as a result, only sectoral imbalances of supply and demand are considered. Issues of inequality in the realm of production, the class character of the state, and the role of finance in bringing about those imbalances are overlooked. For instance, this 'sectoral' approach notes that the state's protectionist policies halted the process of competition and technological innovation in the Mexican

economy, which led to high and uncompetitive prices. Likewise, this view argues that the state did not invest in affordable, non-durable goods and technological development, making the country highly reliant on imported goods and foreign technology and generating a current account deficit. Still, it remains unclear whether wages and labour conditions could have improved if the state would have invested in these sectors and promoted backward and forward linkages among industries. Similar to the previous debate, this is due to the approach's explanation of the Mexican state intervention as policy failures. Here, there is no understanding of the social forces shaping state policies. Instead, the state is seen as an obstacle for the well-functioning of market competition.

The Regulationist approach accounts for the contradictions in the peripheral Fordist regime in Mexico. Yet, its emphasis on overproduction leaves issues of state intervention and class structure unexamined. In other words, the decline of the ISI, and its subsequent expression in the 1982 debt crisis, were due not only to the rigidities of fixed costs, but also to state policy and socio-political dynamics of Mexico's class configuration. This highlights the underestimation by Regulationists of the general role of the state, particularly in the way the Mexican state has guided the dismantling of the ISI by privatising credit and state financing and channeling financial resources to production. The Mexican state, in this view, is not seen as being necessary to accumulation regimes, but rather state actions are conditional upon changes in economic institutions such as the wage relation, the monetary system and the international regime.

The Marxist approach of state monopoly capitalism, in contrast, considers the state as intrinsically tied to the development of the capitalist system. Still, the concept of

'relative autonomy' assumes that the Mexican state's economic policies are subjected to the needs of capital accumulation of the monopoly sector and neglects the role of class struggle in shaping social relations in Mexico. The notion of monopoly capitalism also overlooks the inter-capitalist competition that is intrinsic to capitalism. More specifically, the fact that competition between individual capitalists (or corporations) works is an inner law of capitalism that determines the appropriation of profits by individual capitalists or corporations is not discussed in this approach. While the financial sector in Mexico was highly concentrated during the ISI period, this view cannot explain why competition still existed among several financial groups.

In general, two issues are neglected in the Mexican literature on the transformations of Mexico's economy prior to the 1982 debt crisis. First, the contradictory relationship between state and capital is reduced to a dichotomous opposition between capital and the Mexican nation-state, placing emphasis on the instabilities that foreign debt and costly imports posed on the national economy. As a result, these views are unable to account for the way that the Mexican state intervention has been key to the reconstruction of the Mexican economy, particularly the financial sector, in conflicting ways.

Second, studies of the Mexican economy discuss money, and particularly finance, as a regulatory institution independent from capitalist social relations. Such a conception originates from the disassociation of money from class relations. In other words, finance is only seen as a neutral means of exchange and payment that can be mismanaged, as wage conflicts and rising costs in variable capital and commodities at the level of

production, or as external speculation. These views then conceal the class conditions that allow some economic agents to hold money and control credit and how these conditions have influenced the role of the Mexican state, particularly with respect to its economic decision-making. For this reason, it is necessary to undertake a critical analysis of the explicit role of money and finance in the relation to class conflict and the ways in which the manipulation of money *via* state policies have had important political consequences in Mexico's class structure and the internationalisation of the Mexican economy.

To begin answering these questions of the role of finance in the period crisis and neoliberalism in Mexico, it is first necessary to examine the historical political economy of Mexico. This offers an explanation of the specificity of financial institutions and the characteristics of monetary rules in the Mexican state and these rules' implications on state territoriality and the formation of a unified national economy. The beginnings of these monetary rules and the modern financial system go back to the state's efforts to consolidate a national banking system and the industrialisation process during the Porfirio Diaz's administration in the late 1800s.

The Development of the Mexican Financial System: The Díaz Administration

In the second half of the nineteenth century, particularly during the Díaz Administration (1876-80, 1884-1911), the financial system and the integration of the Mexican economy into international markets were both strengthened.[26] The Díaz

[26] Between 1864 and 1880, three banking institutions were created with foreign and national capital – one foreign bank and two regional banks in Chihuahua. In 1864, the Banco de Londres y México was established as a branch of the Bank of London during the French monarchical regime of Maximilian of Habsburg (1864-67). This bank introduced the issuing of money into the Mexican monetary system. The Banco of Santa Eulalia and the Banco Mexicano were established in Chihuahua in 1875 and 1878 respectively. Both banks had regional resources and the approval of the state government of Chihuahua.

Administration put a banking law into effect in 1897, establishing minimum capital requirements and credit controls.[27] The General Law of 1897 also granted regional banks the power to issue money, thus increasing the power of national capital *vis-à-vis* foreign capital in the banking sector.[28] From the outset, the Mexican state's regulatory framework played a prominent role in governing the emerging financial system. The Mexican state during the *Porfiriato* also provided the conditions under which different economic activities became integrated into the national economy through the banking system. Gradually, the banking system combined various industries, which linked pre-capitalist social relations in agriculture with the capitalist relations embedded in manufacturing and mining.[29] As such, the emergence of a banking system in Mexico assisted in linking spatially distant and sectorally distinct economic activities and social relations to one another through credit.

The support of the state for finance and the process of industrialisation enhanced the power of an emerging Mexican national bourgeoisie. Mario Cerutti and Juan Ignacio Barragán point out that the bourgeoisie that prevailed during the Díaz period cannot be labelled only as foreign capital. Rather, the bourgeoisie in Mexico was characterised by its national basis, but with different groups of the bourgeoisie and their economic

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The purpose of both provincial banks was to channel credit to the bourgeoning mining industry of this region. Later, the two banks that were to exert great influence in the Mexican financial system were founded. The Banco Nacional Mexicano was created in 1881 with French capital and the Mercantil Mexicano was established in 1882 with Spanish capital. Both banks merged into the Banco Nacional de México (Banamex) in 1884. José Antonio Bátiz Velázquez, "Aspectos Financieros y Monetario 1821-1880," en Ciro Cardoso (ed.), *México en el Siglo XIX*, Mexico: Nueva Imagen, 1980, p. 179.

[27] Bátiz Velázquez, "Aspectos Financieros y Monetario 1821-1880," p. 179.

[28] White, *State, Class and the Nationalization of the Mexican Banks*, p. 21.

[29] The hacienda is a mode of production oriented to local markets and its work force consisted of a resident labour force tied to the estates through accumulated debt. Francisco De la Peña, *Formación del Capitalismo en México*, Mexico: Siglo XXI, 1975: p. 233. By fostering the lending of banks to *hacienda* owners, the state could link pre-capitalist social relations into the expansion of capitalism in Mexico.

activities being regionally based.[30] Foreign capital only represented 29 percent of investment in Mexico between 1886 and 1910.[31] While most of the banking assets were controlled by financial institutions that were founded with foreign capital, their profits originated from their articulation with the national capitalist class. Not surprisingly, several officials of the Porfirian regime were closely linked to the operation of foreign banks in the country.[32] Such linkages assured politically connected elites that the federal government would not attempt to confiscate their wealth.[33] In general, the presence of foreign capital in the Mexican banking economy was simultaneously nurturing the Mexican national bourgeoisie.[34] This bourgeoning national bourgeoisie created a power bloc that included big landowners, military politicians, industrialists, and bankers.[35]

The *Porfiriato*, which is the name given to the Díaz Administration, also enhanced the integration of the Mexican economy into international financial markets through foreign borrowing and public debt. By 1888, the Mexican government borrowed British pounds in the London market. By 1894, Díaz expanded Mexico's sources of

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[30] Mario Cerutti y Juan Ignacio Barragán, "Empresarios y Empresas en México. Jabonera de la Laguna. Un Recuento historiográfico a partir de su Archivo," *América Latina en la Historia Económica*, 4, 1995, pp. 78-9.

[31] Mónica Blanco y Eugenia Romero Sotelo, "Cambio Tecnológico e Industria: La Manufactura Mexicana durante el Porfiriato 1877-1911," en Eugenia Romero Sotelo (ed.), *La Industria Mexicana y su Historia*, México: Facultad de Economía UNAM, 1997, p. 186.

[32] For instance, Porfirio Díaz's son was a member of the administrative council of Banco Internacional, a foreign-owned bank. Russell White, *State, Class and the Nationalization of the Mexican Banks*, New York: Taylor and Francis, 1992, p. 20.

[33] Noel Maurer, *The Power and the Money: The Mexican Financial System, 1876-1932*, Stanford: Stanford University Press, 2002, p. 2.

[34] This is not only reflected in the close linkages between government officials and foreign banks, but also in the relationship between banking and other economic activities. The owners and/or administrators of banks would also become investment partners in those firms, particularly industrial enterprises, that borrowed from their banks. Also, banks would provide preferential concession of loans to large-scale agricultural producers. Blanco y Romero, "Cambio Tecnológico e Industria," p. 183.

[35] Roger Hansen, *La Política del Desarrollo Mexicano*, Mexico: Siglo XXI, pp. 192, 196.

foreign borrowing to the United States.[36] Concurrently, the government began issuing short-term public debt in the domestic market.[37] In 1894, the state decided to convert the existing short-term public debt into long-term debt paid in silver in order to diminish the state's financial dependency on private banks. In 1898, the price of silver increased. Mexican bankers, who bought these government bonds at lower prices prior to the increase in silver prices, began placing Mexican public debt in European financial markets to obtain considerable profits.[38] State debt, therefore, further integrated state financing and the Mexican banking system into the international economy.

By the end of the Díaz Administration, the Mexican financial system was characterised by a high degree of concentration. Three banks owned two thirds of all bank capital.[39] The privileges and profits that these banks enjoyed were guaranteed by the state through the credit needs of the state and the social and regulatory structure that prevented competition from other banks.[40] The government, therefore, shaped the banking system to foster the process of industrialisation and ensure its own financial stability *via* the domestic financial system and international financial markets.

In 1908, the Mexican economy went through a phase of stagnation due to the declining production and low demand for agricultural products. This led to an

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[36] Leonor Ludlow y Carlos Marichal, "La Deuda Pública en México en el Siglo XIX: el Difícil Tránsito hacia la Modernidad," en Enrique Cárdenas (ed.), *Historia Económica de México*, Mexico: Fondo de Cultura Economica, 2004, p. 194.
[37] The main holder of public bonds was Banamex. Ludlow y Marichal, "La Deuda Pública en México en el Siglo XIX," p. 195.
[38] Ibid., p. 197.
[39] Two banks, Banamex and the Banco de Londres, issued 80 percent of the notes circulating in the country and had 75 percent of bank deposits. Stephen Haber, "Industrial Concentration and the Capital Markets: A Comparative Study of Brazil, Mexico and the United States," *Journal of Economic History*, 5: 2, 1991, p. 566.
[40] Stephen Haber, "Industrial Concentration and the Capital Markets," p. 568.

intensification of the exploitation of workers and the peasantry as the Mexican industrialists and *hacendados* needed to obtain rents and returns to pay their bank loans, intensifying class conflict.[41] The emergence of a capitalist monetary system in Mexico, with its central state monetary policies dependant upon national private banks fuelling credit conditions, intensified the class contradictions of Mexico's financial and industrial developments in the late nineteenth century. Both financial power and state institutions were central to the clear contradictions that exploded in the Mexican Revolution of 1910.

The Mexican State and the Financial System after the Revolution of 1910

Following the armed struggle from the Mexican Revolution, the resignation of Díaz, and a brief reactionary interlude, Francisco I. Madero was elected president in 1911. This, however, was the beginning of struggle for the control of Mexico's government in a conflict that lasted more than ten years.[42] The struggle for political control threw financial markets into disarray, weakened many of the banks founded during the *Porfiriato*, undermined the confidence in paper money, and obstructed the development of the banking sector until the mid-1920s.[43]

It was not until Plutarco Elías Calles took power in 1924 that conflicts among revolutionary groups were dissolved either through repression or integration of these groups into the political system. The incorporation of the post-revolutionary dispute for

[41] José Antonio Bátiz Vázquez y Enrique Canudas Sandoval, "Aspectos Financieros y Monetarios 1880-1910," en Ciro Cardoso (ed.), *México en el Siglo XIX*, Mexico: Nueva Imagen, 1980, p. 436.

[42] This was due to the opposing interests among the different groups that supported the armed struggle against Díaz's government. For instance, members of the Mexican oligarchy such as President Francisco I. Madero (1911-13), President Victoriano Huerta (1913-14), and President Venustiano Carranza (1915-20) were hesitant to pursue policies of land distribution claimed by the peasant movement led by Emiliano Zapata and Pancho Villa. Lorenzo Meyer, "El Primer Tramo del Camino," en Daniel Cosío Villegas (ed.), Historia *General de México II*, Mexico: El Colegio de México, 1981, pp. 1199-210.

[43] The Revolution led to a currency shortage and general rejection of banknotes. Large amounts of coins were withdrawn from circulation and banknotes were rejected.

political power into the state apparatus was based on the creation of an 'official party,' the National Revolutionary Party (Partido Nacional Revolucionario, or PNR), which later became the Mexican Revolution Party (Partido de la Revolución Mexicana, or PRM) and then the Institutional Revolutionary Party (Partido Revolucionario Institucional, or PRI).[44] The creation of the PNR as an official party reflected the transformation of class relations in the post-revolutionary period, and, in particular, the dependence of the Mexican political bourgeoisie on the state in a cross-class political alliance.[45] It is also worth noting that the PNR crystallized a different power bloc. The Mexican revolution dissolved the alliance between the existing national bourgeoisie and the Díaz government. The power bloc that emerged after the revolution was dominated by local *caciques*, powerful regional caudillos, and the leaders of revolutionary groups. With the PNR, the national bourgeoisie, as well as workers and peasants, were not fully represented into the post-revolutionary state. In the case of the workers' movement, only the Mexican Regional Confederation of Workers (Confederación Regional Obrera Mexicana, or CROM) received the support of the state. The bourgeoisie remained weak and therefore it could not exert great influence over the state. However, the state created the regulations to promote the emergence of a new Mexican capitalist class, particularly in the financial sector.[46]

The political stability of the Calles period created the conditions to place the re-emergence of the Mexican financial system at the centre of the state agenda. The state

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[44] See: Daniel Cosío Villegas, *El Sistema Político Mexicano*, Mexico: Cuadernos de Joaquín Mortiz, 1972.
[45] Adolfo Gilly, *La Revolución Interrumpida*, Mexico: El Caballito, 1971, pp. IV-XIII.
[46] Meyer, "El Primer Tramo del Camino," p. 1189.

created a General Law of Credit Institutions based on article 28 of the Mexican constitution of 1917.[47] The law stipulated the implementation of a property tax on banks, limitations on foreign participation in the banking sector, and constraints on banks to acquire other banking institutions. The law also included the rules, procedures, and the financial structure of the new central bank, which was to be mainly financed by the government. Most of the participation of private capital in the reserves of the central bank consisted of debt repayments from the Mexican state to private banks.[48]

During the Calles Administration, the power of the national capitalist class was enhanced *vis-à-vis* American and European capital, particularly in the banking sector. This was due to the Mexican state's regulations to limit foreign investment in Mexican finance.[49] The Mexican national bourgeoisie also expanded because of the state's authorisation of *financieras* in 1932, which were investment banks that provided financing for industrial firms affiliated to a non-legally recognised entity called a 'financial group.' The emergence of the national bourgeoisie gradually relied on the private banking system as the private sector organised itself around investment banks and its savings were employed for investment in connected manufacturing, mining, and commercial companies.

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[47] Venustiano Carranza's administration established the Mexican Constitution of 1917. The Article 28 of this constitution established that the monopoly over the issuing of money would belong to a government-owned bank. It was not until seven years later that the Banco de Mexico was founded through the Law of Credit Institutions. While article 28 stipulated the constitutional creation of the Mexican central bank, the General Law determined the rules, procedures and organisational structure that the Banco de Mexico and the banking system had to follow. Hilda Sánchez Martínez, "La Política Bancaria de los Primeros Gobiernos Constitucionalistas, Antecedentes Inmediatos para la Fundación del Banco de México," en Leonor Ludlow and Carlos Marichal (eds.), *Banca y Poder en México*, México, Grijalbo, 1986, p. 402.
[48] Sánchez Martínez, "La Política Bancaria de los Primeros Gobiernos Constitucionalistas," p. 403.
[49] One of the exemptions to limitations of foreign investment in Mexico was the protection of American industries in the oil industry.

While the Calles Administration ended in 1928, Calles remained influential in state decisions in subsequent presidential administrations through the PNR. The period between 1929 and 1934 is known as the *Maximato*, since the PNR was exclusively run by Calles as *jefe máximo*.[50] This, in turn, guaranteed the continuity of policies supporting the consolidation of the Mexican financial system and the Mexican capitalist class. While the bourgeoisie was re-establishing itself, Mexican workers and peasants did not have their demands for labour rights and land distribution fulfilled by the various PNR governments. The numerous workers' strikes and peasants' movements that took place across Mexico in the late 1920s and early 1930s were an indication of the prevailing social discontent.[51] These social struggles provided the conditions for the ascendancy of Lázaro Cárdenas to power in 1934.

The Cárdenas Administration differed from previous presidencies in the policies that aimed at carrying out some of the workers' and peasants' demands while fostering state-led industrial and agricultural production. The state created several development banks to finance industrialisation and agricultural production for domestic markets. For this reason, Nacional Financiera (NAFINSA) was established in 1934 to finance private and public economic projects. Likewise, the Banco Mexicano de Comercio Exterior (BANCOMEXT) was created in 1939 to promote the export industry. In that same year, the Banco Nacional de Crédito Ejidal was constituted to provide credit for agricultural activities in community land holdings and large-scale production. State intervention in

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[50] Mexican President Emilio Portes Gil (1928-29), President Pascual Ortiz Rubio (1929-32), and President Abelardo Rodríguez (1932-34) continued Calles's economic policies. Meyer, "El Primer Tramo del Camino," pp. 1203-4.

[51] Gilly, *La Revolución Interrumpida*, p. 353.

the financial system was further facilitated by the revenues of the nationalised oil sector after 1938.[52] The creation of these development banks signalled the state commitment to undertake investment in economic sectors that the private sector was unable or unwilling to finance.

While the state promoted industrialisation and large-scale agricultural production, the majority of the population still remained outside the capitalist labour market. Development banks, however, began linking different economic activities, including the non-capitalist relations of production of the *ejido*.[53] As a result, public credit programs linked these small communal holdings to the dynamics of the national financial system.[54] NAFINSA also promoted the role of Mexican capital in this sector by investing in the initial equity of newly created banks and purchased bonds from private banks, industries, and government.[55] In general, development banks allowed for the strengthening of the Mexican financial system and the incorporation of varied activities and non-capitalist social relations into a post-revolutionary 'national' economy.

The Cárdenas Administration differed from the *Maximato* in terms of its stronger opposition to foreign investment and its favourable policies towards peasants and workers. This was reflected in the transformation of the PNR into the PRM. The reorganisation of the party created the conditions for the full incorporation of unions and

[52] The oil industry, which was mainly owned by American companies, was nationalised under the Cárdenas Administration in 1938.
[53] The *ejido* system was one of the outcomes of the Revolution, which responded to the demands of the peasantry. Under the *ejido* system, the land is owned by the government and only the usufruct of land production is owned by the *ejidatarios* (community land holders). Land redistribution to establish the *ejido* did not happen until Lázaro Cárdenas became president in 1934.
[54] For instance, the National Ejido Credit Bank provided the necessary capital to start and maintain large projects of commercial agriculture in *ejidos*.
[55] White, *State, Class and the Nationalization of the Mexican Banks*, p. 46.

peasant organisations' leaders into the state apparatus.[56] Still, the government support to the financial sector that characterised the *Maximato* not only remained intact, but also intensified in Cardenas's period. The role of the central bank, the Ministry of Finance, and NAFINSA in managing the economy became even stronger from the 1930s on. Through these institutions, the state came to dominate monetary policy, placing concerns with low inflation and restoration of confidence in the monetary system at its centre. Nora Hamilton in fact notes that the permanence of some officials in key positions of the state from the pre-Cardenas period meant that an orthodox approach to monetary policy remained uninterrupted.[57] Also, government officials began acquiring foreign banks in the late 1930s.[58] In particular, the Mexican bourgeoisie that related to the financial sector had begun to consolidate its power within the Mexican power bloc without being directly represented into the PRM.

During the post-revolutionary period, the state mediated the struggle between peasants, workers, and capitalists directly through the official party and state economic intervention. The state created both the political conditions and the regulatory framework for the functioning of the financial system. The Mexican state's political and economic

[56] This incorporation took place through the affiliation of the Mexican Workers confederation (Confederación de Trabajadores Mexicanos, or CTM), National Peasant Confederation (Confederación Nacional Campesina, or CNC) and the National Confederation of Popular Organizations (Confederación Nacional de Organizaciones Populares, or CNOP) into the PRM. Hansen, *La Política del Desarrollo Mexicano*, pp. 137-8.
[57] For instance, Luis Monte de Oca was the Minister of Finance during Calles' *Maximato*, and later he became president of the Central Bank under Cardenas's government. Nora Hamilton, "Mexico: Limits of State Autonomy," *Latin American Perspectives*, 2, 1975, pp. 86-7.
[58] For instance, Abelardo Rodríguez, Mexican President during the *Maximato*, purchased the Banco Mexicano. Along with other businessmen, Gómez Morín, the former policy-maker who designed the Mexican Central Bank, acquired the Banco de Londres and founded the Sofimex bank. Similarly, Montes de Oca bought the Banco Internacional. White, *State, Class and the Nationalization of the Mexican Banks*, pp. 46-7.

mediation of the class struggle through the 'official party' created the conditions for the re-unification of locally and regionally fragmented agricultural and industrial activities that prevailed after the revolution. In general, the Revolution was successful in defeating Díaz's regime. However, the Mexican revolution did not alter the ties between the state and the financial sector. As Noel Maurer notes, the result was the same as in the *Porfiriato* – that is, a high level of financial concentration.[59]

The Mexican State, ISI, and the Consolidation of Finance, 1940-1970

The consolidation of the post-revolutionary Mexican state in the 1920s and 1930s provided the political conditions to implement the ISI. The ISI model consisted of the state's protection of national industries against external competition through import tariffs, price controls over agricultural goods, and cheap industrial inputs from publicly owned companies. The ISI model was first implemented to foster 'easy' industrialisation – that is, the production of consumer goods such as textiles for domestic markets. In this phase of the ISI, the Mexican state supplied credit and infrastructure to encourage the private sector to produce previously imported goods.[60] In contrast to the Cárdenas Administration, Manuel Ávila Camacho (1940-46) and Miguel Alemán Valdés (1946-52) increased state spending on industrialisation (See Figure 1).[61]

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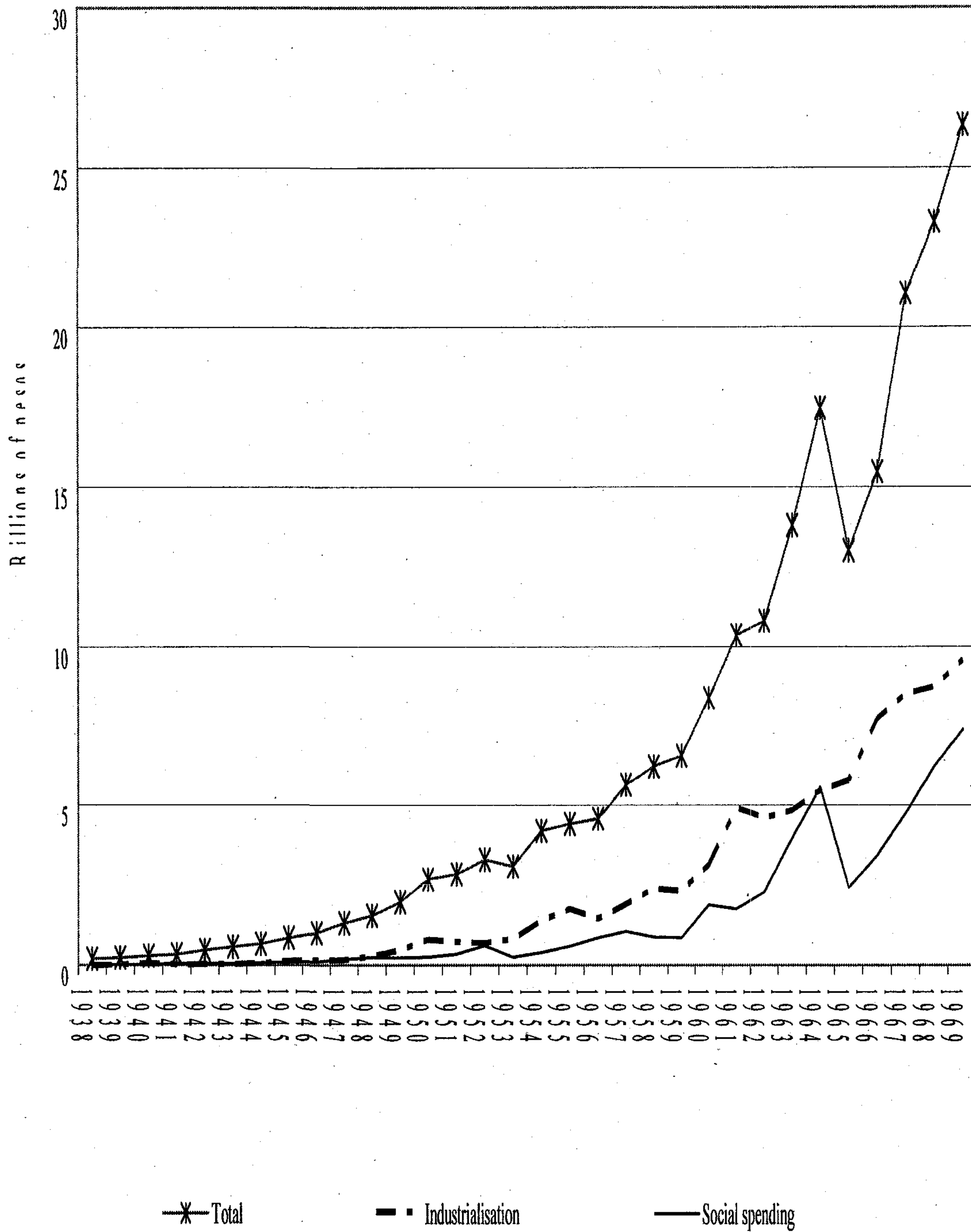
[59] Noel Maurer, *The Power and the Money,* p. 5.
[60] The economic isolation generated by World War II also pushed toward an ISI strategy. Since international production remained stagnant, Mexico could not import goods. Instead, Mexico had to produce them internally. Leopoldo Solís, *Evolución del Sistema Mexicano Financiero*, Mexico, Siglo XXI, 1997, p. 19.
[61] Lorenzo Meyer, "La Encrucijada," en Daniel Cosío Villegas (ed.), Historia General de México, vol. II, Mexico: El Colegio de México, 1981, p. 1278.

Figure 1. Public Investment by Sectors, 1938-69 (billions of pesos)



Source: INEGI, *Estadísticas Históricas de México*, Aguascalientes: INEGI, 1999

In the financial sector, there were two major reforms that influenced the functioning of the ISI in Mexico. First, the state implemented reforms to the General Law of Credit and Banking Institutions in 1941. These reforms consisted of the separation of the financial system into money and capital markets.[62] The regulation allowed deposit and saving banks and *financieras* to operate in money markets. It was mandatory for these financial institutions to supply short-term credits to productive activities. Mortgage houses, capitalisation societies, and fiduciary institutions were established as institutions belonging to capital markets, and were required to provide long-term financing.[63] This reflected the state's efforts to regulate credit supply and financialisation within the economy through the compartmentalisation of the banking system in order to channel resources to different economic sectors.

Second, the reforms of 1949 imposed additional reserve requirements on private banks.[64] The state also required banks to employ 70 percent of these reserves in productive investment in agriculture, livestock, and industry.[65] While the state attempted to create a regulatory framework to control bank credit, these regulations were circumvented by the financial institutions themselves. Different types of banks, for example, were owned by the same holding company. This allowed banks to "operate

[62] Money markets are a set of institutions, such as banks, whose aim is to facilitate the lending and borrowing of money on a short-term basis. Capital markets are the market for securities, where companies and the government can raise long-term funds. Capital markets consist of the primary market, where new issues are distributed to investors, and the secondary market, where existing securities are traded. This includes the stock and the bond market.
[63] White, *State, Class and the Nationalization of the Mexican Banks*, p. 55.
[64] At the end of the World War II, reserve requirements had risen to 50 percent. Monetary authorities further modified the legal reserve requirement in 1949, demanding 100 percent reserves
[65] Banamex, "Modifications in the Legal Requirements," *Review of the Economic Situation in Mexico*, 328, 1953, p. 3.

within a short-term framework despite their classification as commercial or investment banks."[66]

Mexican national capital linked to the financial sector was acquiring increased power within the economy. State legislation, however, still constrained their financial operations, and thus their autonomy and leverage over other sectors, *via* reserve requirements and compartmentalisation. An intended but contradictory relationship between the Mexican state and the private financial system was becoming even more complex.

The period between 1952 and 1970 is commonly known as the epoch of 'stabilising development.' The state's economic policies during this period, under the administrations of Adolfo López Mateos (1952-58), Adolfo Ruiz Cortines (1958-64), and Gustavo Díaz Ordaz (1964-70), consisted of a rather odd mixture of Keynesian-structuralist policies of state intervention along with monetarist objectives of price stability. The term of 'stabilising development' was coined by Antonio Ortiz Mena, who was Finance Minister during most of this period across several presidencies. The term reflected the state's commitment to direct growth without creating inflation.[67] Indeed, inflation only increased 4.22 per year on average during the period, while the Mexican economy was growing by 6.74 percent.[68]

During the period of stabilising development, the state implemented a second phase of the ISI strategy *via* a policy of 'heavy industrialisation.' This consisted of the

[66] White, *State, Class and the Nationalization of the Mexican Banks*, p. 58.
[67] Antonio Ortiz Mena, "Discurso Pronunciado en la XXXIV Convención Bancaria, Guadalajara, Jalisco, 28 Marzo de 1968," *Las Finanzas Públicas en el Desarrollo Socio-Económico de México*, Mexico: SELA, 1969, p. 164.
[68] Guillén Romo, *Orígenes de la Crisis en México*, México: Ediciones Era, 2000, p. 35.

Mexican state's undertaking of capital-intensive and long-maturity investments such as steel mills, coal mines, paper mills, and oil refineries. Unlike the previous period, the state intervened in the economy, not only through public investment, but also through tax exemptions and subsidies.[69] The state promotion of ISI gave NAFINSA a more important role in the management of the Mexican economy, particularly as the main creditor to private and public investment.[70] NAFINSA also began issuing public bonds in European capital markets in the late 1960s.[71]

During this period, the Mexican state also allowed the dollarisation of the financial system – that is, the increasing use of dollars relative to pesos in commercial transactions.[72] The tendency towards dollarisation can be explained in terms of international exchange rate stability, which guaranteed the value of the peso in relation to other currencies. But investors especially borrowed in dollars because loans in Mexican pesos were more expensive than in foreign currencies.

As a whole, the implementation of the ISI model in Mexico benefited the national bourgeoisie. While the policies did not reject foreign investment, they still limited the extent of foreign operations within Mexico.[73] Foreign capital was mainly concentrated in the manufacturing sector and it only represented 8.5 percent of the total private

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[69] White, *State, Class and the Nationalization of the Mexican Banks*, p. 59.
[70] By 1961, NAFINSA was the creditor to 533 enterprises and held stock in 60 industrial companies. Bennet and Sharpe, "The State as a Banker and Entrepreneur," p. 176.
[71] NAFINSA issued public bonds for 100 million dollars at favourable rates in the European markets. Ortiz Mena, "Discurso Pronunciado en la XXXIV Convención Bancaria," p. 160.
[72] By 1950, 25 percent of total obligations in the financial system were denominated in US currency. Nine years later, this proportion increased to 38 percent. White, *State, Class and the Nationalization of the Mexican Banks*, p. 61.
[73] Meyer, "La Encrucijada," p. 1279.

investment.[74] Its importance in the economy had diminished due to the state's strategy of 'Mexicanisation.' Foreign investors were required to share majority ownership with Mexican capital.[75] The protection of national capital and the state's role in fostering national private sector's activities transformed and enhanced the power of the capitalist class in Mexico. This process of 'Mexicanisation' strengthened financial groups, particularly through the role of *financieras* in these organisations. These banks were allowed to have monetary obligations in national and foreign currencies and did not have to comply with high levels reserve requirements.[76] In this way, different institutions could distribute funds amongst each other to obtain the most profitable returns and circumvent state regulations. As a whole, 'Mexicanisation' and 'heavy' industrialisation expanded the control of financial groups over different sectors of the economy.[77]

Transformations of the Mexican bourgeoisie also reflected the changes the overall class structure was undergoing. These changes consisted especially of the entry of 75 percent of the population into the labour market, particularly in the manufacturing and service sector (See Figure 2).[78]

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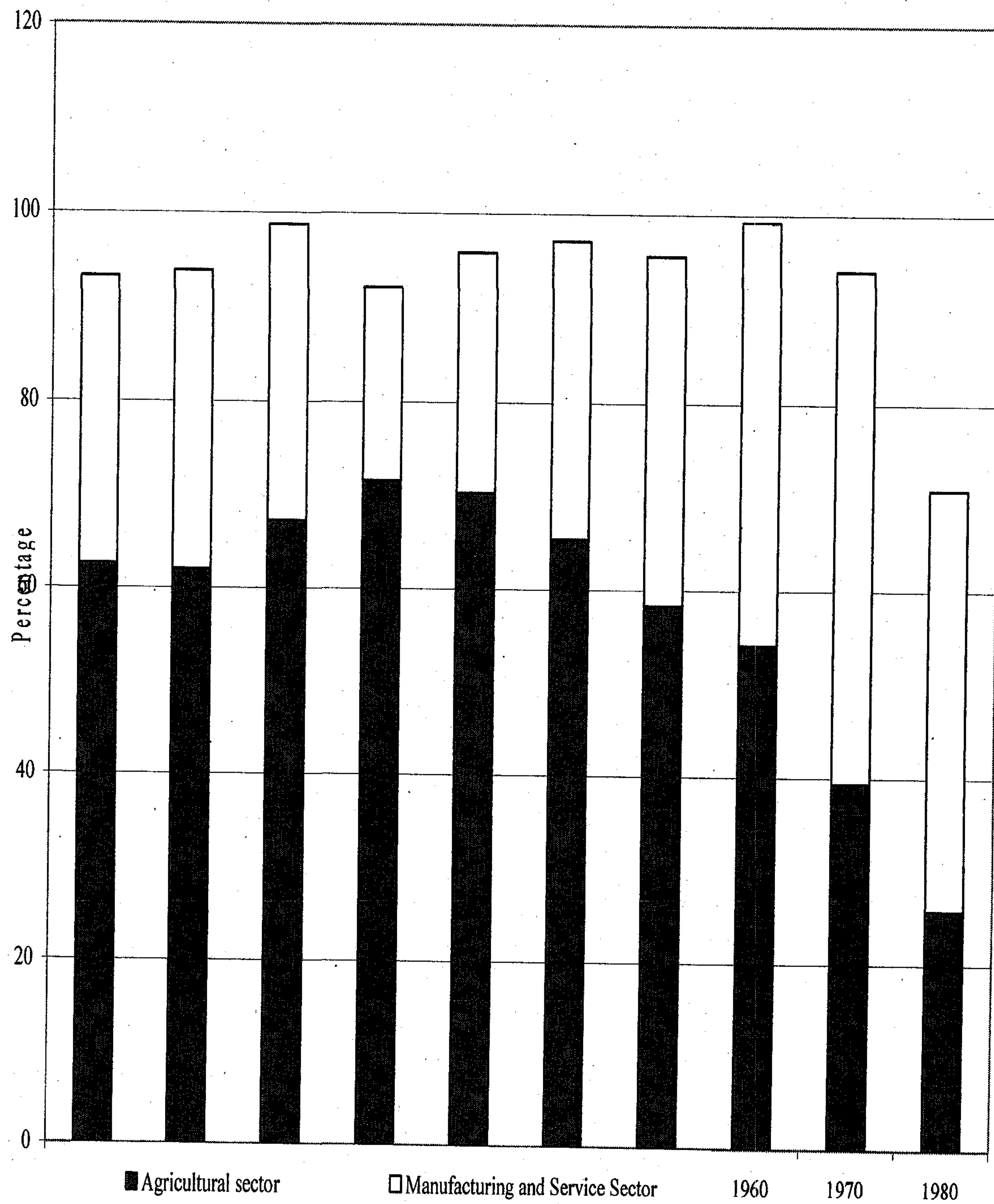
[74] Meyer, "La Encrucijada," p. 1292.
[75] Ibid.
[76] While reserve requirements were reduced in 1953, deposit and savings banks required 30 percent legal reserves of the banks' current liabilities. Banamex, "Modifications in the Legal Requirements," p. 4.
[77] The Bancomer group, for instance, owned 52.39 percent of a chemical and mining company, 30 percent a cotton producer, and 40.5 percent of another chemical firm. Bancomer also had full participation in Seguros Bancomer (an insurance company) and Bancomer Casa De Bolsa (a brokerage house). The evolution of the Bancomer group in this period illustrates the consolidation of financial institutions of national origin in the Mexican economy. Antonio Mendoza Hernández, *De la Nacionalización a la Privatización de la Banca Comercial en México: Reestructuración de los Grupos de Capital Financiero, 1982-1992*, Unpublished Master's Thesis Facultad de Economía, UNAM, 2001, p. 45.
[78] In 1950, there were 3.8 million rural and urban workers. Twenty years later, there were 8.5 million people working as wage labourers. Gregorio Vidal, "Los Hechos," *La Inflación en México*, Mexico: Editorial Nuestro Tiempo, 1984, p. 29.

Figure 2. Employment by Sector (percentage)



Source: INEGI, *Estadísticas Históricas de México*, Aguascalientes: INEGI, 1999.

This facilitated the implementation of a monetary policy based on the expansion of wage-labour in the economy. The state implemented price and wage ceilings to prevent domestic prices and wages from rising.[79] This, in turn, created social discontent and a series of student and workers' protests through the 1950s and the 1960s.

State investment in the economy increased between 1950 and 1970. In order to sustain public spending, the state had to borrow abroad from private and public institutions.[80] Public investment was also increasingly being financed through the issuing of government bonds, which were purchased by the Mexican private sector.[81] Government securities in bank portfolios doubled from two billion pesos in 1950 to four billion pesos in 1959, and these amounts indicate the increasing privatisation of state financing.[82] Indeed, the initial implementation of ISI and the policies of 'stabilising development' created economic growth underpinned by anti-inflationary policies. The expansion of credit and governmental indebtedness with private national and international financial institutions also helped to sustain the value of the peso and the process of industrialisation as well as to solve temporarily constraints on government spending. This, however, made state financing increasingly dependent on the private sector. This dependency was created by state regulations seeking to maintain the ISI and strengthen the private Mexican financial sector (See Figure 3).

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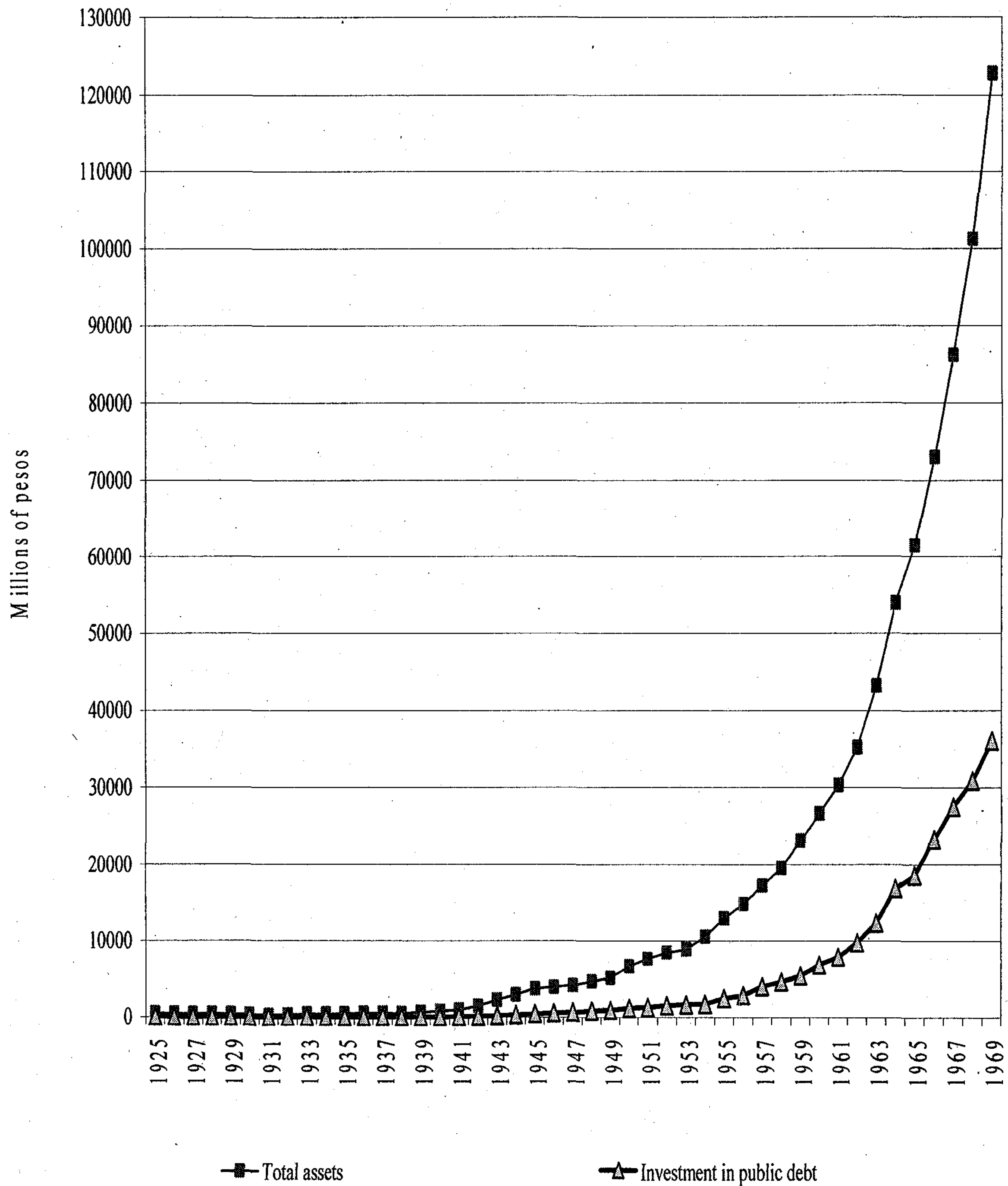
[79] It is worth noting that the Mexican state could not sustain the fixed parity system in 1948 and had to abandon fixed exchange rates. By 1949, the Central Bank accumulated more reserves and in negotiation with the IMF, the Mexican economy was able to return to the parity system. Vidal, "Los Hechos," p. 35.

[80] Between 1950 and 1964, the Mexican state had borrowed 3.1 billion dollars from outside of the country, including 800 million dollars from the World Bank and 660 million of dollars from the US government's EximBank. Rosario Green, *El Endeudamiento Público Exterior de México, 1940-1976*, Mexico: El Colegio de México, 1976, p. 145.

[81] Guillén Romo, *Orígenes de la Crisis en México*, p. 49.

[82] White, *Class, State and Nationalization of the Mexican Banks,* p. 63.

Figure 3. Expansion of Mexican Private Banks, 1925-69 (millions of pesos)



Source: INEGI, *Estadísticas Históricas de México*, Aguascalientes: INEGI, 1999.

Particularly, the role of the private financial sector reflected the changing configuration of the Mexican power bloc. While the leaders of peasants' and workers' organisations exerted influence over state policy through the PRI, the private sector did not.[83] Instead, the private financial sector, along with other industries, affected economic decision-making *via* trade chambers such as the Mexican Association of Bankers (Asociación Mexicana de Banqueros, or ABM) and the Confederation of Employers of the Mexican Republic (Confederación Patronal de la Repúblic Mexicana, or COPARMEX).[84] Such configuration remained relatively stable between 1940 and 1982.

The Economic Policies of 'Shared Development' and the Oil Bonanza, 1970-82

Two major changes occurred in the international economy in the early 1970s. First, the United States suspended its obligation to buy dollars from foreign central banks at $35 to the ounce of gold. With the floating of the gold, other economies stopped intervening in the foreign exchange market, leading to a flexible exchange rate system.[85] Second, as national currencies started to float, individuals, firms, and national governments had to spread their risks by investing in different currencies through international lending. Increasing oil prices during 1973-74 incited financial intermediation through the recycling petrodollars from surplus oil-exporting economies to deficit countries. As a result, many developing countries, such as Mexico, gained access to international capital markets.[86]

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[83] The PRM changed its name to PRI in 1946.
[84] Meyer, "La Encrucijada," p. 1310.
[85] Ibid., p. 1298.
[86] Francisco Luiz Corsi, "A Questão do Desenvolvimento à Luz da Globalização da Economia Capitalista," *Revista de Sociologia e Política*, 19, 2002, p. 20.

In this context, Luis Echeverría (1970-76) became president of Mexico. Early in his administration, Echeverría emphasised the importance of the role of the state in the economy, and promised to channel more state resources into the social spending coordinate.[87] The Echeverría Administration called this economic orientation 'shared development.' The implementation of 'shared development' was influenced by the lack legitimacy of Echeverría's presidency. This was due to the social discontent caused by the Tlatelolco Masssacre of 1968 and the deteriorated social conditions of the Mexican working classes.[88] The Echeverría Administration implemented an expansionary spending policy to lower the prices of public goods, increase subsidies, and provide agriculture with cheap inputs to foster workers' consumption and peasants' income. Also, the state channelled resources to create welfare institutions, which were demanded by the working classes in their numerous strikes.[89] State spending was facilitated by the inflow of petrodollars into the economy.

The expansionary spending raised the opposition of the business sector. Business organisations such as the Coordinator Entrepreneur Council (Consejo Coordinador Empresarial, or CCE) attacked the government's 'interventionist' and 'populist'

[87] *Presidencia de la República,* "Luis Echeverría Álvarez, Mensaje a la Nación," México, 1970, p. 12.
[88] In 1968, troops opened fire on the protestors, killing students and unionised workers in the Tlatelolco square. During this period, 10 percent of the poorest families received four percent of the total country's income, 80 percent of the population received 59 percent of total income, and 10 percent of the wealthiest families concentrated 37 percent of total income. Clark Reynolds, "Por qué el Desarrollo Estabilizador de México fue en Realidad Desestabilizador," *El Trimestre Económico,* 63: 250, 1977, p. 677.
[89] For instance, the state promoted increases in the minimum wage. The state also created FOVISSTE, an institute that offered affordable housing to workers. Food to poor communities was subsidised through price controlled milk, tortillas, eggs, beans, and rice. Viviane Brachet-Márquez, "El Estado del Bienestar en México: Nacimiento, Auge y Declive," *UNRISD Política Social en Latinoamérica en Un Contexto de Desarrollo,* New York, UNRISD, 2003, p. 32.

policies.[90] Despite criticism of Echeverría's policies, the Mexican private sector, particularly that linked to finance, benefited considerably during his administration. Echeverría's presidency promoted further concentration of activities under the form of integrated holding companies. This is the case of the 1970 and 1974 reforms to the General Credit Law.[91] The reform of 1970 legally recognised *de facto* financial groups, and the reform of 1974 allowed the creation of multiple service banks. The latter reform eliminated the compartmentalisation established by the Mexican state in the 1940s. Mexican financial groups were then able to attract deposits through various financial instruments and amalgamate different capitals within Mexico under the command of few corporations. These reforms created a tendency towards a more intense concentration and centralisation of the Mexican financial system.[92] These laws also allowed financial groups to expand their influence in the market through the acquisition of other insurance companies, brokerage houses and investment funds[93] (See Figure 4).

In this period, Mexican monetary policies assisted in the development of a more sophisticated and profitable financial system. The Mexican state implemented, through the central bank, a restrictive monetary policy, thus increasing interest rates.[94] As credit in pesos became more costly, bank profits increased.

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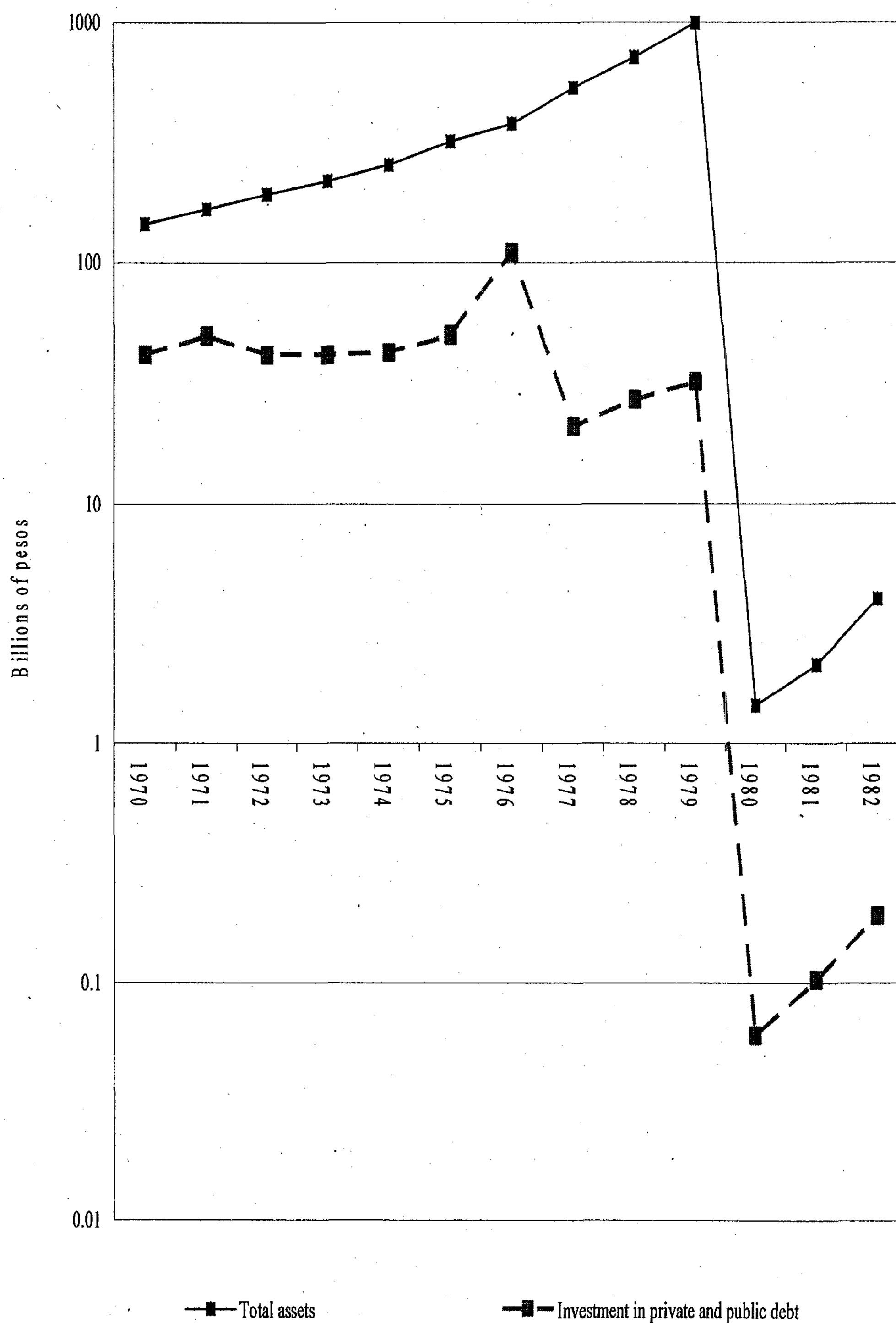
[90] Américo Saldívar, *México, Fin de Siglo*, México: Editorial Alianza, 1989, p. 53.
[91] María Elena Cardero y José Manuel Quijano, "Expansión y Estrangulamiento Financiero 1978-1981," en José Manuel Quijano (ed.), *La Banca Pasado y Presente*, Mexico: CIDE, 1983, p. 262.
[92] In 1970, 18 banks controlled 75 percent of total assets. In 1979, only six banks controlled the same percentage. White, *State, Class and the Nationalization of the Mexican Banks,* p. 86.
[93] For instance, multiple service banks' profits increased between 40 and 60 percent toward the end of the decade. White, *State, Class and the Nationalization of the Mexican Banks*, p. 87.
[94] Guillén Romo, *Orígenes de la Crisis en México*, p. 53-54.

Figure 4. Expansion of Mexican Private Banks, 1970-82 (billions of pesos)



Source: INEGI, *Estadísticas Históricas de México*, Aguascalientes: INEGI, 1999.

Also, the continuity of previous administrations of resisting any peso devaluation, led to further dollarisation of the Mexican financial system. The Mexican state encouraged deposits in dollars within Mexico at high interest rates in order to increase banks deposits that would eventually serve as a credit source for state financing. These deposits were called 'Mexdollars.'[95] Dollarisation also encouraged the conversion of liabilities into dollars, since it was cheaper to pay interest rates in that currency than in pesos. In general, the fixed exchange rate of 12.5 pesos per dollar, and the expectation that oil revenues would reduce the possibility of devaluation, promoted this trend of holding liabilities and assets of dollars in the Mexican financial system.[96]

According to Tello, 'Mexdollars' were in fact deposits in pesos taken to Mexican banks in exchange for bank notes in dollars. Consequently, the Mexican central bank had to cover these foreign currency obligations through international borrowing and oil revenues.[97] For this reason, foreign debt increased from 4.5 billion dollars in 1971 to 19.6 billion in 1976.[98] As such, foreign debt became central to the dollarisation of the Mexican financial system.

The Mexican state not only relied on foreign debt, but also on public debt, which was mostly purchased by private national banks. In order to increase its public debt, the state created alternative financial instruments such as the *petrobonos* and the *cetes*

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[95] 'Mexdollars' deposits increased from 3.5 percent of the total GDP to 5.2 percent in 1981. Between 1970 and 1975 dollar accounts in Mexican banks were no greater than 20 percent. By 1976, these accounts made up 32.5 percent of total bank deposits. This figure jumped to 42 percent in 1981. Tello, *La Nacionalización de la Banca en Mexico*, p. 48.

[96] The country augmented its petroleum sales abroad in 1974. George Grayson, *The Politics of Mexican Oil*, Pittsburgh: University of Pittsburgh Press, 1980, p. 55.

[97] Tello, *La Nacionalización de la Banca en Mexico*, p. 46.

[98] Foreign debt represented 24 percent of the total gross domestic product. Guillén Romo, *Orígenes de la Crisis en México*, p. 49.

denominated in pesos, which offered high returns. The purpose of the creation of these bonds was to diminish the state's dependency on direct bank credit. Between 1965 and 1970, the *petrobonos* and *cetes* were 41 percent of the total public debt (See Figure 5).[99] This signalled the increasing securitisation of state financing and its central role in consolidating a Mexican financial sector strongly linked to international markets through dollarisation

Business profitability, it should be noted, stood in stark contrast to the circumstances of the working classes and the peasantry. In 1960, the share of wages in the total GDP was 31.2 percent. By 1974, wages only represented 19.4 percent of total GDP.[100] By 1975, inflation rose substantially and balance of payment deficits worsened. In an attempt to reduce the country's trade deficit, the government devalued the peso by 50 percent in 1976.

Capital flight began to accelerate and inflation went up as the Echeverría Administration entered its final months. About 460 million dollars left Mexico in 1975.[101] By 1976, this amount reached 1.983 billion dollars.[102] Echeverría left office in the wake of a major foreign exchange crisis in 1976 that threatened public finances and increased the country's public and private debt in foreign currency.

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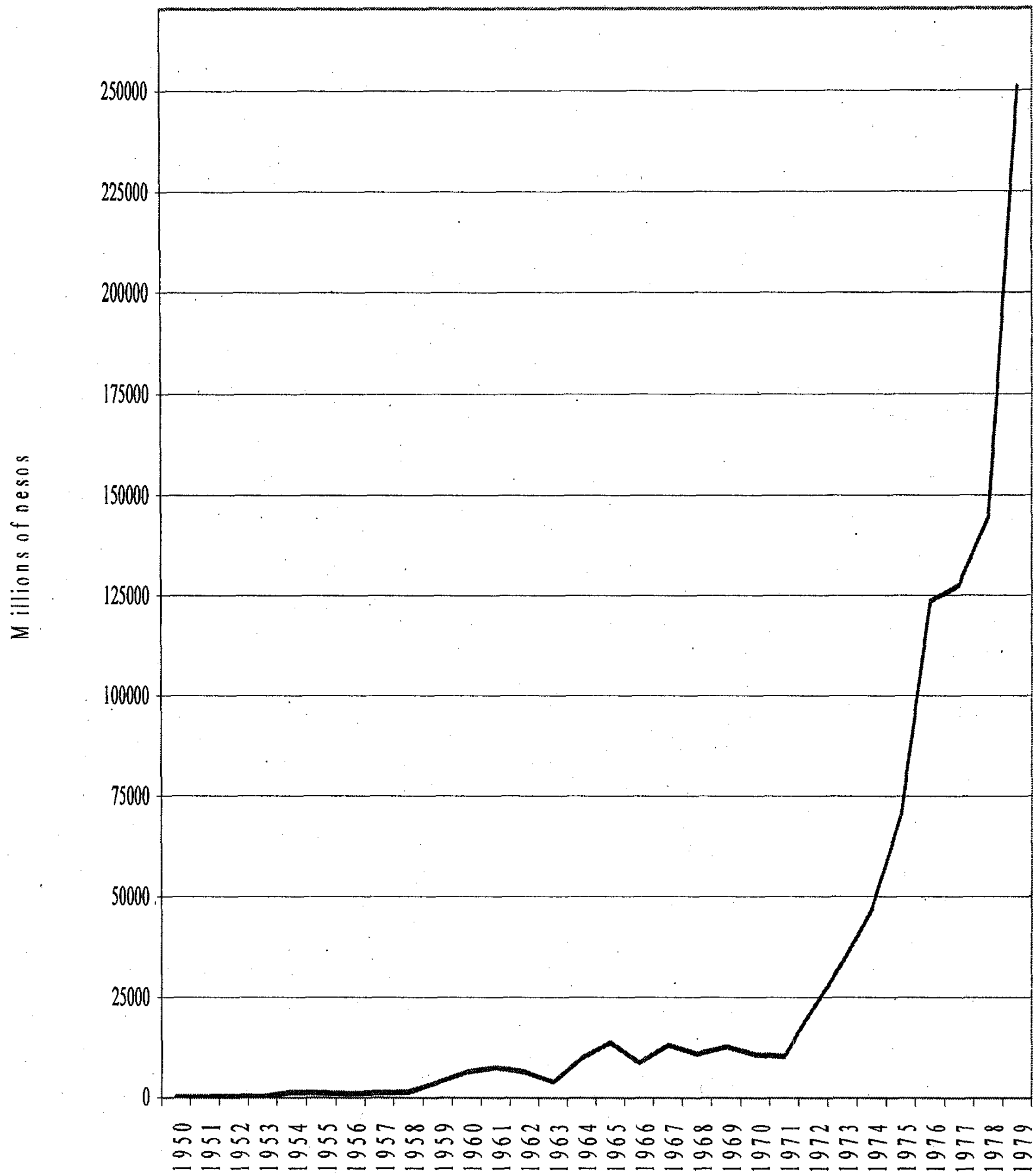
[99] Guillén Romo, *Orígenes de la Crisis en México*, p. 49.

[100] Saldívar, *México, Fin de Siglo*, p. 27.

[101] Banco de México, *Informe Anual 1976*, México, 1977, p. 24.

[102] For this reason, the Mexican government requested from the American government a line of credit. The U.S. assisted the International Monetary Fund (IMF) in designing a stabilisation program for Mexico that included a rescue package of 1.2 billion dollars of funds from the Treasury Department and the Federal Reserve Bank. Guillén Romo, *Orígenes de la Crisis en México*, p. 54.

Figure 5. Government Income from Credit and Other Financial Instruments (millions of pesos)



Source: INEGI, *Estadísticas Históricas de México*, Aguascalientes: INEGI, 1999.

José López Portillo, the PRI nominee, was elected president in 1976 in the midst of devaluation and the implementation of the IMF stabilisation program. The Lopez Portillo Administration adhered to the IMF's program of economic austerity.[103] Later, government revenues increased due to newly discovered oil reserves. Early in his term in office, López Portillo announced that exports of oil products would increase from 100,000 to 1.1 million barrels a day, and Mexico became the world's fourth largest oil exporter.[104] This, in turn, provided the economy with the conditions to grow an average of eight percent between 1977 and 1981.[105]

The state used oil income, in combination with international bank loans and public debt such as *petrobonos* and *cetes,* to increase state resources. State foreign debt increased from 2.98 billion dollars in 1977 to 14.5 billion dollars in 1981. Mexican state financing was also becoming increasingly securitised - that is, financed by private firms rather than by the central bank. Public debt represented 58 percent of total state financing between 1977 and 1982. This financing had a largely national basis since public debt was mostly held in the portfolio of Mexican banks.[106]

The López Portillo's administration followed policies of high interest rates to make government bonds more attractive for investors. This occurred in a context where the United States also raised interest rates to control inflation. In 1979, the Mexican monetary authorities increased interest rates to an average of 15 and 20 percent when

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[103] This austerity program included wage ceilings, increases in the price of public goods, limits on public foreign debt, a reduction in state spending and government employment, and a three billion dollar limit on public sector external debt. Guillén Romo, *Orígenes de la Crisis en México*, pp. 54-5.
[104] Richard Fagan, "The Realities of US-Mexican Relations," p. 698.
[105] INEGI, *Estadísticas de Contabilidad Nacional Producto Interno Bruto, 1977-1981*, Mexico, 2004.
[106] Tello, *La Nacionalización de la Banca en México*, p. 43.

U.S. interest rates rose only eight percent.[107] The difference between interest rates in these government securities made peso-denominated public debt an attractive investment.

The state also intervened in the exchange rate market by defending the peso. The central bank bought pesos with the international currency obtained from foreign loans and oil revenues. The central bank's defence of the peso and the state's authorisation of a larger number of U.S. dollar accounts and liabilities in Mexican banks led to another wave of dollarisation of the Mexican financial system.[108]

In order to encourage credit for the private sector, the López Portillo Administration promoted the creation of a stock exchange market in 1977.[109] The state also introduced several tax exemptions for those companies quoting in the stock exchange market.[110] Dollarisation of the economy and the stock market provided several companies, particularly those belonging to financial groups, with favourable conditions for expansion. Ten brokerage houses controlled 66 percent of the operations in the stock exchange. Seven of these houses belonged to one financial group. Financial groups such as Banamex and Bancomer not only gained control over stock operations through their brokerage houses, but also had large sums invested in those companies quoting in the stock exchange.[111]

Besides the issuing of stocks, large financial groups had access to dollar loans at lower interest rates than in pesos. Before 1974, the accumulated foreign debt of the

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[107] Cardero y Quijano, "Expansión y Estrangulamiento Financiero, 1979-1981," p. 279.
[108] Banco de México, *Informe Anual 1982,* Mexico, 1982, p. 188.
[109] Cardero y Quijano, "Expansión y Estrangulamiento Financiero," p. 232.
[110] Ibid., p. 233.
[111] Banamex, for instance, had 17 billion pesos invested in 150 firms quoting in the Mexican stock exchange. Ibid.

private sector was 4.549 billion dollars. In contrast, the private debt obtained in the year of 1980 alone was 5.60 billion dollars.[112] The ten most profitable firms linked to financial groups represented 34 percent of total private sector's foreign debt.[113]

The stock exchange, the dollarisation of loans, and private foreign debt allowed the private sector to enlarge their markets and profits.[114] The percentage of total profits acquired by the two main banks – Banamex and Bancomer – increased substantially in less than a year.[115] In contrast to the situation in the private sector, the living conditions of workers kept deteriorating since wages continued to lag behind price increases.[116]

Inflation rose to 44.69 percent by August 1982 (See Figure 6).[117] Public foreign indebtedness doubled between 1978 and 1981, from 26.2 billion dollars to 53 billion.[118] On February 1982, the López Portillo Administration allowed the dollar price of the peso to double in order to discourage foreign-exchange speculation.[119] This led to more speculation and capital flight. Between 1980 and 1982, capital flight totalled 28 billion dollars.[120]

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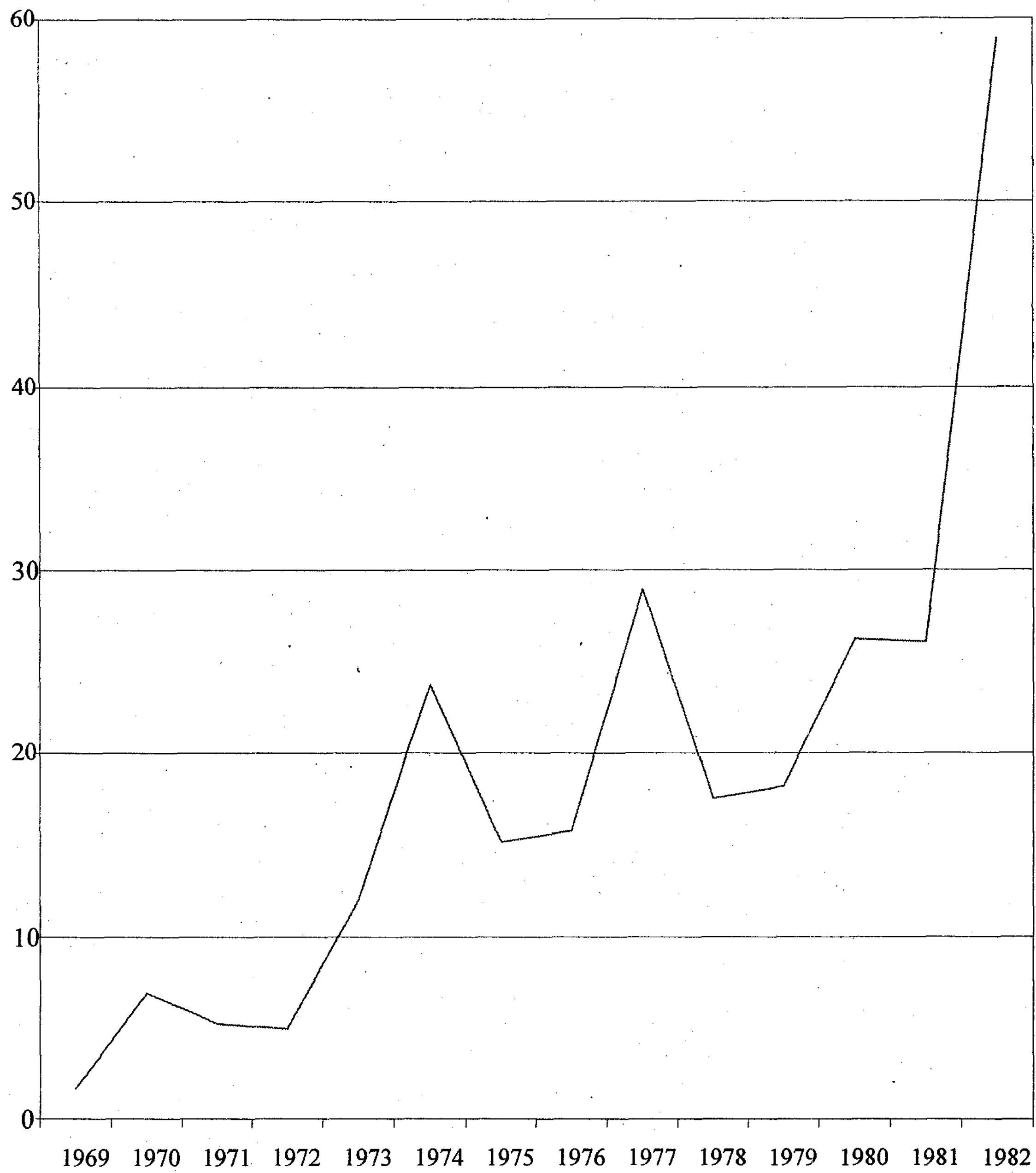
[112] About two thirds of these debts were short-term loans. Between 1977 and 1982, the private sector's share of the total Mexican foreign debt was 23.4 percent. Cardero and Quijano, "Expansión y Estrangulamiento Financiero," pp. 240, 249.
[113] Ibid., p. 274.
[114] For instance, Banamex bought hotels and mining industries. By 1979, Bancomer and Serfin, the other two large banks, had control over 39 and 62 firms, respectively. Salvador Cordero et al., "Proceso de indemnización y perspectivas de los nuevos grupos económicos en México," en Ricardo Pozas, et al. (eds.), *Las Empresas y los Empresarios en el México Contemporáneo,*" México: Grijalbo, 1989, p. 447.
[115] Bancomer, for example, held 40 percent of total profits in 1978, whereas this figure jumped to 62 percent in the following year. White, *State, Class and the Nationalization of the Mexican Banks,* p. 87.
[116] Jesús Cervantes González, "La Inflación y la Distribución del Ingreso y la Riqueza en México," *Distribución del Ingreso en México III*, Mexico: Banco de México, p. 31.
[117] Banco de México, *Índice de precios*, México, 2004.
[118] Tello, *La Nacionalización de la Banca en México*, p. 75.
[119] The exchange rate increased from more than 26 pesos per dollar in January 1982 to 46 six pesos per dollar three months later. Banco de México, *Informe Anual 1982*, p. 189.
[120] This occurred in a context of rising international interest rates and declining oil prices, which made it difficult for the López Portillo Administration to sustain the worthiness of the peso. María Estela Dillares

Figure 6. Inflation Rate, 1969-82



Source: INEGI, Estadísticas Históricas de México, Aguascalientes: INEGI, 1999.

Cisneros, "México en la Perspectiva Global del Cambio Estructural: Estado Moderno y Gestión Estratégica," *Gestión y Estrategia*, 4, 1993, p. 10.

On July 1982, the Mexican government decided to implement a dual parity exchange rate system. This system consisted of a preferential exchange rate (49.13 pesos per dollar) and a floating exchange rate (75.33 pesos per dollar). The preferential rate was used to facilitate the import of necessary goods for industrial production and the private sector's payment of their dollar loans. The government also made all banks pay dollar accounts in pesos in order to repossess $12 billion dollars.[121] A month later, the government allowed Mexican banks to pay dollar deposits at a third of the preferential exchange rate, which was 69.50 pesos per dollar.[122]

On August 1982, the government announced three more dramatic devaluations of the peso. During that same month, the central bank announced to the IMF that its reserves were not sufficient to make a 300 million dollar debt payment to syndicated banks.[123] Mexican authorities declared a ninety-day suspension of debt principal payments while beginning negotiations for payment rescheduling with the United States treasury, the IMF, and international bank syndicates. In September 1982, the government adopted full exchange controls and nationalised the domestic banking system in an effort to stem capital flight. Two months later, the government concluded a rescheduling accord with the IMF, in which the Mexican monetary authorities requested 450 percent of Mexico's quota in this organisation.[124] In exchange, the IMF requested the implementation of austerity measures, including the reduction of public foreign debt and

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[121] Banco de México, *Informe Anual 1982*, p. 191.
[122] Ibid., p. 193.
[123] Rosario Green, *Lecciones de la Deuda Externa de México de 1973 a 1997: De Abundancias y Escasez,* México: Fondo de Cultura Económica, 1998, p. 52.
[124] Tello, *La Nacionalización de la Banca en México*, p. 220.

public spending, and the increase of international reserves.[125] The López Portillo Administration came to an end amidst a large financial crisis that had repercussions worldwide and that was to affect the economic policies of Mexico in the years to come.

The economic developments in the Echeverría's and López Portillo's administration show the consolidation of a modern national financial system. The expansion of the national financial sector created the conditions where financial groups were able to bind themselves with financial activities worldwide through their access to foreign currency markets and foreign debt. This balance of forces within the country eventually determined the ways in which the Mexican state became the lender-of-last-resort to solve the debt crisis, making state intervention indispensable for the reproduction of stable economic conditions.

State, Finance, and Accumulation in Mexico

State and finance are two key aspects that have influenced to a great extent the constitution of the Mexican economy, from the reconstruction of the economy in the post-revolutionary period and the implementation of the import-substitution model to the setting of conditions for the further internationalisation of Mexico and its internal bourgeoisie. First, the state created the regulatory framework and the political stability necessary to rebuild the financial system after the Revolution. Likewise, the functioning of the Mexican central bank in the late 1920s guaranteed commercial banks that the state would back up all banking transactions, lending directly to financial institutions in times of crisis, and indirectly reinforcing confidence in the system by assuring the ability of

[125] Tello, *La Nacionalización de la Banca en México*, pp. 221-2.

borrowers to pay. Second, the state promoted the Mexican financial sector through the policies that encouraged the creation of financial groups and development banks that linked different economic activities and the securitisation of state debt that socialised the costs of ISI industrialisation.

While the Mexican state played a central role in the implementation of the ISI, Mexican finance formed an integral component to the structuring of this model of industrialisation. On the one hand, the organisation of Mexican firms around *financieras* allowed the channelling of resources to the group's own industrial and commercial firms, fostering the process of industrialisation. Financial groups, therefore, linked the financial and productive processes in the development of Mexican capitalism, anticipating the realisation of the productive process or delaying the presence of money in the moments of production and circulation.[126] On the other hand, state policies that encouraged the development the ISI guaranteed the profits of private banks. More specifically, private banks channelled resources to state-promoted sectors because the state guaranteed their profitability through state trusts.[127]

Still, the relationship between state and finance was not without conflicts. Private financial firms increasingly opposed the state's use of the reserve system to decrease budget deficits and the state's efforts to decrease its direct reliance on private credit through the issuing of public debt. This, in turn, expressed the balance of forces within Mexico and the power bloc. Here, the Mexican state's role in mediating the class struggle entailed the creation of policies of employment, subsidies and agricultural

[126] White, *State, Class and the Nationalization of the Mexican Banks*, p. 59.
[127] Ibid., p. 60.

investment. Such policies required alternative financing through public debt and development banking, despite the private sector's opposition. All this suggests that the demise of the ISI model in Mexico was not the outcome of rigidities among industrial sectors, between the economy and state regulation, or the prevalence of monopolies.

Conclusion

Despite the insights of the Mexican studies of the ISI, there are some important shortcomings in the analysis. These approaches overlook the centrality of money in transforming the nature of production in Mexico and shaping the development and the demise in the ISI and the internationalisation of the Mexican economy. In many of these debates, the state is either seen as an individual and coherent entity or as a representative of the capitalist class as a whole. This tends to neglect the presence of societal forces within the state that influence changes in policy-making.

By considering more closely the social roles of money and state power, one can understand the transformation of the Mexican economy in terms of the social relations that characterise the reproduction of capitalism in the country. While this chapter focused on the role of the Mexican state in constituting the financial sector and the centrality of finance in the ISI model, it remains necessary to address how the Mexican state and the class configuration have shaped the integration of the Mexican economy into international finance and the globality of accumulation in the current period of neoliberalism, particularly through its role in constituting and regulating both the financial system and capitalist social relations within the nation-state. This will be the subject of the next chapter.

Part 2 Finance and the Restructuring of the Mexican State

Chapter 4

Finance, the Internal Bourgeoisie, and Transformations of the Mexican State

The Mexican economy experienced important changes during the 1980s and 1990s. In a period of twelve years, Mexico went from the most indebted economy in the world to the most successful 'emerging market' and a *bona fide* partner of industrialised nations through its membership in the Organisation of Economic Cooperation and Development (OECD) and the North American Free Trade Agreement (NAFTA). This raised a diversity of interventions on the nature of the internationalisation of the Mexican economy. These debates focused on whether the opening of the Mexican economy was the outcome of trade, foreign investment and technology, changes in the state elite or the external imposition of finance by international institutions. In contrast to these debates, this chapter argues that the analysis of the national manifestations of global accumulation requires acknowledging the national class processes through which capital reproduces itself nationally and internationally. This offers an understanding of the ways in which the Mexican state policies that preceded and followed the 1982 debt crisis allowed for the strengthening of an internal bourgeoisie, which articulated itself to international accumulation though the latter's control over financial markets.

This chapter first discusses several perspectives in the Mexican literature on economic internationalisation. The chapter suggests some of the limitations of these analyses in addressing the historical conditions that allowed for the internationalisation of the Mexican economy and the development of capital markets in the country. Second, I present an overview of the economic developments that took place between 1982 and

1994. Third, the chapter discusses the state policies and the class forces that shaped the internationalisation of the Mexican economy prior to the debt crisis. Fourth, I examine the economic mechanisms of state intervention during the 1980s and 1990s to understand their effects on the internationalisation of the Mexican economy through finance and the recomposition of class relations in Mexico.

Economic Internationalisation in the Mexican Debate

The changes that the Mexican economy experienced throughout the 1980s and the 1990s have brought about an intense debate regarding the effects that market mechanisms, economic opening, financial liberalisation, and limited state intervention produced. Indeed, several analysts have considered that, in the case of Mexico, markets bring the most optimal economic outcomes by allocating resources efficiently.[1] Still, these studies have also emphasised the importance of state intervention in providing the appropriate conditions for the functioning and the managing of international markets. The economic rationalist view considers internationalisation as the opening of the Mexican economy to trade and flows of capital and gives particular attention to the role of the financial sector in internationalising the Mexican economy.[2] Financial internationalisation is conceived of as Mexico's renewed linkages to international capital markets, the elimination of restrictions on foreign bank entry, and the purchase of Mexican securities by non-residents.[3] It is also argued that Mexican companies have

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[1] See: Robert J. Barro and Xavier Sala-i-Martin, *Economic Growth*, Massachusetts: MIT Press, 2005; Robert Barro, *Determinants of Economic Growth,* Massachusetts: MIT Press, 1998.
[2] Pedro Aspe Armella, *Economic Transformation: The Mexican Way*, Cambridge: the MIT Press, 1993, p. 124.
[3] International Monetary Fund, *International Capital Markets*, Washington: IMF: 2000, p. 158.

facilitated the process of internationalisation through their exports and the opening of branches in other countries.[4]

In terms of state intervention, Aspe Armella considers that orthodox approaches to the monetary control of inflation did not work in Mexico, since these policy prescriptions failed to recognise the need of a political and social consensus to support structural reforms.[5] Likewise, Miguel Mancera Aguayo argues that market mechanisms by themselves cannot correct inadequate macro-economic policies.[6] The state has to play an active role in limiting public finances, controlling credit aggregates, implementing income policies, and providing the financial system with a supervisory framework to guarantee appropriate capitalisation levels.[7] This view is also reflected in the policies advocated by the World Bank. In the *World Development Report* of 1997, the World Bank indicates that changes in global markets pressure states to become more efficient. The restructuring of the state, in this view, has not kept pace with all the global transformations. The state is required to be a regulator and facilitator of economic and financial adjustment and liberalisation.[8] These views have given rise to the term 'second generation reforms.' As Michel Camdessus notes, "sound social, political, and economic

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[4] Aspe Armella, *Economic Transformation*, p. 124.
[5] Ibid., p. 22; Claudio Loser, et al., "Mexico, The Strategy to Achieve Sustained Economic Growth," *IMF Occasional Papers*, Washington: IMF, 1992, p. 12.
[6] Miguel Mancera Aguayo, "El Sistema Financiero," en Roberto Hernández y Alfredo Harp Helú (eds.), *México en la Década de los 90s,* Mexico: Banamex, 1993, p. 115.
[7] Ibid., "El Sistema Financiero", p. 117; Loser, et al., "Mexico, The Strategy to Achieve Sustained Economic Growth," p. 12.
[8] World Bank, *The State in a Changing World. World Development Report 1997,* New York: Oxford University Press, 1997, p. 2.

institutions are a necessary, if not sufficient, conditions for the sustained implementation of sound macroeconomic policies."[9]

Other studies of the Mexican economy have advocated state intervention to promote technology and innovation. This neo-Weberian approach considers that the functioning of international markets has been accelerated because of technological developments. The internationalisation of economies is seen as a process triggered by technology, which allows capital to move across borders through virtual markets.[10] Such mobility, it is argued, has prevailed over national borders, particularly in the case of finance.[11] As a result, countries are pressured to remain competitive through the adoption of technology and the promotion of research and development in this sector.[12]

In this respect, it is argued that Mexico has been unable to integrate into the 'new economy.' According to Victor Soria, the 'new economy' has accentuated Mexico's 'technological unemployment' and technological and financial dependency on Northern countries.[13] This approach goes on to suggest that faltering technological adaptation is partly due to the inability of the Mexican state to create competitive advantages, such as

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[9] Michel Camdessus, "Second Generation Reforms: Reflections and New Challenges," *Opening Remarks to IMF Conference on Second Generation Reforms*, Washington, 8 November 1999.
[10] Fernando Jeannot Rossi, "Nueva Economía," *Análisis Económico*, 19: 42, 2004, p. 96; Alejandro Dabat, "Globalización, Capitalismo Actual y Nueva Configuración Espacial del Mundo," en Jorge Basave, et al. (eds.), *Globalización y Alternativas Incluyentes para el Siglo XXI*, México: Porrúa, p. 68.
[11] Berenice Ramírez López, "América Latina frente al Proceso de Globalización: Retos y Potencialidades," *Problemas del Desarrollo*, 24: 95, 1993, p. 90.
[12] José Luis Estrada López, "Nuevo Modelos de Crecimiento Endógeno en México," *Análisis Económico*, 15: 31, 2000, p. 4; Delia Crovi Druetta, "Desafíos del Mundo Virtual," en Elsa Patiño y Jaime Castillo (eds.), *Globalización y Restructuración Territorial*, Puebla: Programa Editorial de la Red de Investigación Urbana, 1999, pp. 211-20.
[13] Victor M. Soria, "Conversión Tecnológica en México. El Rezago de la Industria de Bienes de Capital," *Problemas del Desarrollo*, 81, 1990, p. 111.

state assistance, to encourage the high-tech sector and the training of workers.[14] The global economy requires the transformation of the Mexican state into a 'competition state' in order "to coordinate the creation of knowledge and constitute a basis of endogenous technological development."[15] The lack of state intervention to promote technological development is considered the main explanation for the low productivity and lack of competitiveness of the Mexican economy.[16] For this reason, this neo-Weberian interpretation advocates cooperation between the state and markets in order to promote investment and technological development.[17] Technological investment, Miguel Angel Rivera Ríos notes, can improve "Mexico's position in the international division of labour."[18]

Alternative studies focus on the personal and social attributes of government officials to explain the internationalisation of the Mexican economy. The main argument is based on the rise of a technocracy within the Mexican state. The rise of this social group is explained as an unintended consequence of the organisational changes that took place in Mexican institutions and the PRI after the 1970s. Miguel Angel Centeno and Sylvia Maxfield argue that before the 1970s, there was a division of labour within the government between the *tecnicos* and the politicians.[19]

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[14] Soria, "Conversión Tecnológica en México," p. 129.
[15] Estrada López, "Nuevo Modelos de Crecimiento Endógeno en México," p. 10.
[16] Fernando Sánchez Ugarte, "Introducción: La Competitividad Industrial en México, Determinantes Básicos y Perspectivas," en Antonio Argüelles y Antonio Gómez (eds.), *La Competitividad Industrial en México Frente a la Concurrencia Internacional,* Mexico: FCE-NAFINSA, 1994, p. 20.
[17] Alfredo Guerra Borges, "Variantes sobre el Futuro de la Regionalización," en Jorge Basave et al. (eds.), *Globalización y Alternativas Incluyentes para el Siglo XXI,* México: Porrúa, pp. 239, 243.
[18] Miguel Angel Rivera Ríos, "México en la Economía Global: Reinserción, Aprendizaje y Coordinación," *Problemas del Desarrollo,* 32: 127, 2001, p. 79.
[19] The *tecnicos,* who did not have an affiliation with the official party, were highly specialised in certain areas of economics. The politicos, on the other hand, had a strong affiliation with the official party. See:

During the 1970s, president Luis Echeverría created the Secretary of Planning and Budget (Secretaría de Planeación de Presupuesto, or SPP), which took over some of the Central Bank and Finance Ministry (Secretaría de Hacienda y Crédito Público, or SHCP) functions. This significantly reduced the *politicos* control over public finance and allowed the administration to entrench a new technocratic elite who had a broader academic background and were trained mostly in American universities. [20] This group, prior to taking over the Secretary of Planning, had already belonged to well-defined personal and political networks closely tied to the PRI. Following the 1982 debt crisis, this technocratic elite consolidated its power within the Executive and the PRI and began implementing market-oriented economic policies. This perspective suggests that the debt crisis and the increasing complexity of the financial problems facing the state required economic expertise and experience in finance, inextricably tying economic solutions to the Mexican crisis to the technocrats.[21] The growth of presidential power and the emergence of this homogeneous group of technocrats enabled the state to carry out structural reforms necessary to internationalise the Mexican economy. According to this view, this was the project of the privatisation of state-owned enterprises, financial deregulation, fiscal austerity, and trade liberalisation through NAFTA.[22]

Miguel Angel Centeno and Sylvia Maxfield, "The Marriage of Finance and Order: Changes in the Mexican Political Elite," *Journal of Latin American Studies*, 24: 1, 1992.

[20] Centeno and Maxfield, "The Marriage of Finance and Order," pp. 42-3.

[21] See: Pamela K. Starr, "Monetary Mismanagement and Inadvertent Democratization in Technocratic Mexico," *Studies in Comparative International Development*, 3: 4, 1999.

[22] See: Peter Evans, "The State as Problem and Solution: Embedded Autonomy and Adjustment," in Stephen Haggard and Robert Kauffman (eds.), *The Politics of Economic Adjustment: International Constraints, Distributive Conflict and the State*, Princeton: Princeton University Press, 1992.

Conversely, the Regulationist approach to the internationalisation of the Mexican economy emphasises the structural disequilibrium between the core and peripheral states, such as Mexico, and between finance and production. This perspective points out that the coherence between the economic institutions of the ISI model and the political system collapsed, giving rise to a new regime of accumulation that sought to lower production costs to make firms more competitive.[23] Jesús Lechuga and Pierre Salama note that the flexibilisation of labour takes place in the context of financialisation, that is the transference of resources from productive to financial activities.[24] The Regulationists suggest that what is traded in financial markets is not surplus value, but rather expectations on the value of a stock, increasingly rendering the financial sector autonomous from the rest of the economy.[25] This process of financialisation occurred in Mexico because of the opening of its economy to foreign investment and the flow of capital from core countries to Mexico, weakening the Mexican state.[26] The Regulationist approach, therefore, considers that the Mexican state has failed to restore the stability in the new regime since it has not strengthened the internal market and linked the export sector to domestic industries.[27]

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[23] Jesús Lechuga Montenegro, "Acumulación y Regulación en la Economía Mexicana," *Problemas del Desarrollo*, 32: 125, p. 73.
[24] See: Pierre Salama, Financiarización Excluyente en las Economías Latinoamericanas," *Comercio Exterior,* 1997.
[25] Lechuga Montenegro, "Acumulación y Regulación en la Economía Mexicana," p. 79; Lechuga Montenegro, "La Crisis Estructural de la Economía Mexicana 1970-1995," p. 26.
[26] Lechuga Montenegro, "Acumulación y Regulación en la Economía Mexicana," pp. 78-80, 88.
[27] See: Enrique Dussel, "El Cambio Estructural del Sector Manufacturero Mexicano 1988-1994," *Comercio Exterior*, 1995.

Marxist approaches to the internationalisation of the Mexican economy have focused on the expansion of the capital relation worldwide.[28] According to Ana Esther Ceceña, the current process of internationalisation can be understood as the expansion of capitalist relations of production across the world that overcomes national borders as the main framework of capitalist reproduction.[29] Carlos Vilas suggests that the current phase of transterritorial expansion of capital through finance has weakened the territoriality of economic activities and the actions of peripheral states such as Mexico.[30] This is due to the internationalisation of the production process, which has allowed corporations to move to low cost locations through free trade and has facilitated the mobility of capital through financial liberalisation.[31] The process of internationalisation, this perspective argues, also relies on the hegemonic capacity of some states and the dominance of international financial institutions.[32] In Mexico, for instance, U.S. corporations, IMF structural adjustment policies, and American military and intelligence strategies have opened the Mexican economy to allow the entry of American investment and foreign intervention into the country.[33]

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[28] José Lorenzo Valle, "Un Recurso Viable para Contrarrestar la Volatilidad y la Incertidumbre, Factores Desencadenantes de las Crisis Económico-Financieras Contemporáneas," en Julio Gambino (ed.), *La Globalizacion Economica-Financiera: Su Impacto en Lationamerica*, Buenos Aires: CLACSO, 1998, p. 218.

[29] Ana Esther Ceceña, "Sobre las Diferentes Modalidades de Internacionalización del Capital," *Problemas del Desarrollo,* 81, 1990, pp. 19, 29.

[30] Carlos Vilas, "Estado y Mercado en la Globalización, La Reformulación de las Relaciones entre Política y Economía," *Revista Sociología Política,* 14, 2000, pp. 29, 36.

[31] Ceceña, "Sobre las Diferentes Modalidades de Internacionalización del Capital," p. 35; Vilas, "Estado y Mercado en la Globalización," p. 36.

[32] See: Ana Esther Ceceña and Andrés Barreda, *Producción Estratégica y Hegemonía Mundial*, México: Siglo XXI, 1995.

[33] John Saxe-Fernández, "Globalización e Imperialismo," en John Saxe-Fernández (ed.), *Globalización: Crítica a un Paradigma,* México: Plaza y Janés, 1999, pp. 42-3.

The economic rationalist and the technological view of the internationalisation of the Mexican economy have become the predominant approaches to study finance and the articulation of Mexico to the global economy. These approaches, however, present problematic assumptions regarding the nature of internationalisation. Both analyses see internationalisation as an inevitable and apolitical process. In this way, the power relations that exist behind the process of internationalisation are absent from their analyses because of a focus on the neutrality of markets and technology. These views, Eduardo Barrera notes, "fetishize the labour and social forces that sustain the so-called flows of capital and goods."[34] The emphasis on the importance of state policy in dealing with the negative externalities of the market and fostering technological innovation overlooks the social relations that underlie state policies of economic opening.

In the case of the 'technocratic' explanation, state intervention in the context of capital internationalisation is often reduced to the agency of state officials. Such an assumption tends to overdetermine the links between internationalisation, the technocrats, and international financial institutions. In other words, policy convergence among these forces is rendered a foregone conclusion. Such an interpretation reduces the state to a reified structure and policy-making to decisions made by state officials with particular personal attributes. This, in turn, conceals the processes by which financial liberalisation and internationalisation of capital are domesticated.

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[34] Eduardo Barrera Herrera, "Telecomunicaciones y la Fábrica Global: Flexibilidad Espacial y Fetichismo de la Información," en Elsa Patiño y Jaime Castillo (eds.), *Globalización y Reestructuración Territorial*, Puebla: Programa Editorial de la Red de Investigación Urbana, 1999, p. 209.

The Regulationist concern for a stable regime of accumulation in Mexico overlooks the power relations that maintain the regime's coherence. The Regulationist approach also tends to see money as independent of the capitalist social relations. This is reflected in the concept of 'autonomisation' of finance from production in Mexico. The Regulationist school also considers that the nation-state has been weakened by the international mobility of capital triggered by the financialisation process. This is due to the notion that the nation-state and international markets are alternate regulatory institutions vying for position, and thus necessarily opposed to one another. As a result, absent from the analysis and conclusions is how the Mexican state has been able to maintain an active and interventionist economic role in light of the so-called weakening of the state brought about by the process of internationalisation.

Alternative Marxist approaches to internationalisation offer valuable insights on the political and class nature of the internationalisation of capital. The notion that internationalisation is the expansion of capital social relations globally allows an understanding of the social agents and the power relations behind the process. But this still sets foreign capital and 'core' states in opposition to the Mexican nation-state. The predominance of finance internal to Mexico is reduced to an interpretation of the policy imperatives of the International Monetary Fund and the interventionism of international banks, transnational corporations, and U.S. imperialism. The only articulation of the Mexican nation-state to international accumulation is the reliance of the national economy on foreign borrowing, foreign trade, and foreign investment. Such a position ignores the centrality of the territoriality of the Mexican state in internalising global

capitalism within the country. The social significance of debt and finance in the internationalisation of capital, its implication in the reproduction of the Mexican class structure (the internal bourgeoisie in particular), and Mexico's evolving position in the globality of finance is either ignored or under-theorised. In contrast to the Mexican literature on economic internationalisation, the argument here is that an analysis of the national manifestations of global accumulation in Mexico requires acknowledging the class processes through which capital reproduces internationally. For this reason, the study of the De la Madrid and Salinas Administration is crucial to understanding the role of the state in the reconfiguration of the class structure, which influenced the way the economy further integrated itself to international financial markets.

The Beginnings of Neoliberal Restructuring: The Mexican Economy, 1982-1988

In December 1982, Miguel de la Madrid came to power and his administration undertook a series of orthodox economic changes. The new administration implemented policies of austerity under the auspices of the IMF Letter of Intent, which comprised a restructuring plan of three years.[35] In this letter, the Mexican government agreed to reduce the current account deficit, decrease inflation by 80 percent, decrease public spending in relation to total GDP to 8.5 percent in 1983, 5.5 percent in 1984, and 3.5 in 1985. Also, the Letter of Intent of 1982 established a five billion dollar limit to the Mexican government's foreign debt. In terms of wage policies, the agreement stated that

[35] Secretaría de Hacienda y Crédito Público, "Carta de Intención con el FMI," *Comercio Exterior*, 32: 11, 1982.

wages would be regulated in accordance with labour demand and productivity. The letter also indicated that Mexico would decrease trade barriers and promote exports.[36]

While the goals of macroeconomic policy were set by the IMF, the mechanisms to implement those reforms were left to the Mexican state. For this reason, the De la Madrid Administration formulated a program to achieve the macro-stability stipulated in the 1982 Letter of Intent. This program was called the Immediate Program of Economic Reordering (Programa Inmediato de Reordenación Económica, or PIRE). This plan consisted primarily of a two- tier exchange rate, and price increases in public goods, which eventually resulted in rising interest rates and public debt reductions.[37] In the context of a double exchange rate regime, the De la Madrid Administration devised the FICORCA in 1983. FICORCA was a foreign exchange risk coverage trust fund to assist large firms in restructuring their liabilities in foreign currencies. All Mexican firms with long-term debt in foreign currency and payable to foreign financial institutions were able to purchase, at a controlled rate, the amount of dollars necessary to pay the debt's principal through a government-guaranteed exchange rate.[38]

The government also raised interest rates in assets to increase the value of the peso, curtail money circulation, and diminish inflation. Interest rates in peso-

[36] Secretaría de Hacienda y Crédito Público, "Carta de Intención con el FMI."
[37] The exchange rate system was divided into a floating regime, and a managed regime, with 13 percent daily slippage in the Mexican peso against the US dollar. The latter was considered to be central to finance the private sector's foreign debt and the imports necessary for industrial production. Presidencia de la República, "Primer Informe de Gobierno del Presidente Miguel de la Madrid," *El Mercado de Valores,* 63: 36, 1983, p. 906.
[38] These instruments had a maturity of 8 years or more with a 4-year grace period. Mark Stone, "Corporate Sector Restructuring: The Role of Government in Times of Crisis," *Economic Issues*, 31, 2001, p. 42.

denominated public debt were nine percent higher than its American counterparts.[39] The increase in interest rates was accompanied by price rises of public goods. In 1983, controlled prices of public goods increased 78.3 percent while market prices rose to 82 percent. As a result of rising prices of public good, government income increased 76.5 percent and international reserves amounted to 8.13 billion dollars in 1984, which assisted in the process of foreign public and private debt repayment.[40]

Due to limitations on obtaining credit from the central bank and foreign lenders, the Mexican state increased the issuing of public bonds, particularly *cetes*. The *cetes* represented 18 percent of public financing in 1983. By 1986, these bonds' percentage of state financing was 82 percent.[41] These assets were sold *via* the Mexican stock market to firms and individuals, and directly increased the importance of secondary markets within Mexico.[42]

Several factors contributed to the expansion of financial operations in the Mexican stock market. First, the issuing of government debt at profitable rates became an important incentive for private investment in the stock exchange. The average interest rate increased from 45.9 percent in 1982 to 110 percent in 1986. As a result, the amount of *cetes* held by private firms and individuals increased from 30 percent in 1984 to 52

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[39] Banco de México, *Informe Anual 1984*, Mexico, 1984, p. 33.
[40] Ibid., p. 23.
[41] Teresa López González, *Fragilidad Financiera y Crecimiento Económico en México*, Mexico: Plaza y Valdes, 2001, p. 64.
[42] Ibid., p. 71.

percent in 1987.[43] Second, private stocks turned into a profitable investment due to FICORCA, which protected private firms' debt against devaluation.[44]

Another strategy of De la Madrid's presidency was the reorganisation of the nationalised banking system and the privatisation of non-banking financial institutions, such as brokerage houses and insurance companies.[45] In the first case, the De la Madrid Administration placed particular emphasis on the indemnification of the former owners of the nationalised Mexican banks.

By 1984, the government spent 142.7 billion pesos in compensation for 43 banks, which represented 92 percent of the total banking capital.[46] De la Madrid also implemented policies to close down 11 banks and merge 20 banking institutions. This resulted in a reduction of banking institutions from 60 to 29 banks in 1984. The number of financial institutions eventually decreased to just 18 banks.[47]

The De la Madrid Administration also began selling shares of non-banking service companies. In return for the sales, the state obtained 70 billion pesos. By March 12, 1984, 80 percent of the shares of non-banking financial institutions were sold.[48] The scheduling of the sales favoured former bank owners because they were given the first opportunity to purchase shares of non-banking financial institutions.[49] These former

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[43] Jorge Basave Kundhardt, "La Estrategia Financiera del Gran Capital en México," *Problemas del Desarrollo*, 21: 81, 1990, p. 91.
[44] López González, *Fragilidad Financiera y Crecimiento Económico en México*, p. 75.
[45] See: Gilberto Calderón Ortiz, "Privatización de la Banca en México," *Gestión y Estrategia*, 1, 1991.
[46] Banco de México, *Informe Anual 1984*, p. 37.
[47] While the banking system became public enterprises, NAFINSA remained the main state bank providing credit to public firms. By 1987, NAFINSA allocated 94 percent of its total credit to state owned enterprises. Jesús Silva Herzog, "Speech at the Mexican Banking Association," *Review of Economic Situation in Mexico*, 60: 705, 1984, p. 307.
[48] Ibid., p. 306.
[49] White, *State, Class and the Nationalization of the Mexican Banks,* p. 135.

bankers often bought these shares using the indemnity they received from the nationalisation.[50]

The policies of economic restructuring not only involved changes in economic policy, as stipulated in Mexico's Letter of Intent with the IMF, but this transformation also caused significant changes in the political relations among the Executive, the official party, and its corporatist structure. This materialised in the Pact of National Solidarity (Pacto de Solidaridad Nacional). This was the first of several tripartite agreements between the government, businesses, and official labour unions. This first agreement was signed on August 1983. The private sector and official unions agreed to lower inflation through slow growth in wages and prices, higher labour productivity, the expansion of production and job creation, and reductions in state subsidies for public goods.[51] This first pact did not become a fundamental part of De la Madrid's strategy to lower inflation in the first years of his administration. Instead, policies of price stability were based on the tightening of money supply and government spending. The National Solidarity Pact, however, became central to the anti-inflationary strategy by the end of De la Madrid's period.

Despite De la Madrid's policies of price stability, high inflation rates and growing fiscal deficit continued, and economic growth remained slow. For this reason, the IMF suspended disbursement loans in September of 1985. This announcement led to another

[50] Banamex is a case in point. It created a trustee in another bank called Inverlat. The indemnity bonds of ex-shareholders of Banamex constituted this trustee. The main objective was to trade these bonds for shares in the Banamex IFNBs and Brokerage House Banamex. Also, the former shareholders of Banamex traded their indemnity bonds for shares in Inverlat, which eventually merged with Banamex when it was privatised. Ibid., p. 141.

[51] Presidencia de la República, "Pacto de Solidaridad Nacional," *El Mercado de Valores*, 63: 33, 1983, p. 835.

run on the peso and a new balance-of-payments crisis. The government reacted to the situation by devaluing the peso by 46 percent, further reducing spending and domestic credit and opening the economy to free trade. In the latter case, De la Madrid's administration expected that exports would restore external balance and restrain domestic prices by encouraging competition. In July 1985, the government substantially reduced import licensing requirements and raised the share of total imports exempt from licensing. By 1986, the government's commitment to economic liberalisation was strengthened by Mexico's entrance to the General Agreement of Trade and Tariffs (GATT).[52]

By the end of 1986, the government relaxed credit to the private sector in an effort to ease the economy out of recession. At the same time, De la Madrid's administration expressed its intention to lower interest rates, thereby also affecting yields in public bonds. This change in monetary policy, along with the due payments of the private sector's debt, led to further speculation, which resulted into the Mexican stock market crash of 1987.[53] Consequently, firms increased the prices of their products to pay for their enlarged dollar liabilities.[54] This caused an increase of the consumer price index by 125 percent and a withdrawal of private investment from public bonds.

The government, in turn, was forced to supply a large amount of resources to repay yields in government debt and guarantee the controlled exchange rate to protect private debt against devaluation. Because of its inability to supply these resources, the

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[52] Alicia Girón, "Deuda Externa: El Reto del Siglo XXI," *Problemas del Desarrollo*, 21: 81, 1990, pp. 64-5, 69.
[53] López González, *Fragilidad Financiera y Crecimiento Económico en México*, p. 77.
[54] Banco de México, *Informe Anual 1987*, p. 21.

state ceased to intervene in the exchange market. As a result, by 1987, the two-tier exchange rate regime had become a single floating one. [55]

Following the stock market crash of 1987, external financing was again made available through a debt rescheduling plan proposed by the U.S. Secretary of the Treasury, James A. Baker. The Baker Plan called for rescheduling 83 percent of the 52.2 billion dollars of Mexico's public sector debt contracted prior to 1985. The plan stipulated that the debt would be repaid over a 20-year period, with a seven-year grace period. Multilateral agencies agreed to lend an additional six billion dollars and commercial banks 7.7 billion dollars. The Baker Plan also established the rescheduling of 9.7 billion dollars of private debt owed to international banks over a 20-year period with seven years' grace. In all, the agreement provided Mexico 12.5 billion dollars in new private and official credit.[56]

Also, the Mexican government stopped devaluing the peso at rates higher than the inflation rate. This signaled the beginning of a shift in state policy towards anti-inflationary measures based on political alliances within the PRI. The government forged a new joint agreement with official leaders of the labor, peasant, and business sectors to restrain wages and prices in December 1987. This accord, known as the Economic Solidarity Pact (Pacto de Solidaridad Económica, or PSE), promised to reduce Mexico's monthly inflation rate to two percent by the end of 1988. The PSE also required further reductions in public spending and credit, higher tax revenues, and tighter monetary policy. All these measures were intended to reduce the fiscal deficit and curb inflation.

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[55] Banco de México, *Informe Anual 1987*, p. 21.
[56] Ibid., p. 47.

The new revenues included an increase in the value-added tax, a new personal income surtax, and elimination of tax exemptions. The government raised prices of public goods and services, and increased interest rates to promote savings and reduce capital flight.[57]

After the signing of the PSE, the inflation rate fell considerably from 159 percent in 1987 to 52 percent in 1988 with real GDP growing only at 1.3 percent.[58] The gradual recovery of Mexico's international reserves in 1989 and 1990 allowed the government to sustain a credible exchange rate and finance the deterioration of its external account. The social cost of the economic reforms, however, was largely burdened by labour *via* subsidy reductions, price increases in public goods and low wages. Between 1982 and 1985, real wages declined between 0.2 and 22.9 percent annually. In this period, the overall share of GDP going to wages fell from 35.9 percent to 28.9 percent while prices continued increasing throughout the 1980s. Workers and peasants were even more affected by reductions in subsidies for basic foods and goods, further lowering the purchasing power of Mexicans.[59]

The economic instability led to social discontent and a series of union strikes. These confrontations were either repressed by the state or contained by labour leaders of the PRI. The 'official power' of the workers' movement, in turn, diminished the leverage of independent unions and other social movements, and channeled attention from issues

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[57] The PSE also included a structural adjustment component emphasising trade liberalisation and privatisation of state enterprises. Secretaría de Hacienda y Crédito Público, *Pacto de Solidaridad Económica*, Mexico: NAFINSA, 1987.

[58] Nora Lustig, *Mexico: The Remaking of an Economy*, Washington D.C: Brookings Institute, 1992, p. 51.

[59] In 1982, 50 hours of work enabled the average worker to purchase 22 food items from the standard 'basic market basket.' By 1986, 85 hours of work were needed to make the same purchase. Francisco Báez y Enrique González Tiburcio, "Impacto de la Crisis en las Condiciones de Vida: un Ensayo Descriptivo," en Carlos Tello (ed.), *Mexico: Informe sobre la Crisis, 1982-1986,* Mexico: UNAM, 1989, p. 453.

of economic policy towards electoral matters. As a response to the demands from groups that demanded the liberalisation of the political system, De la Madrid attempted to have an open competition for PRI presidential candidates as opposed to the *dedazo*, which consisted of the traditional appointment of the presidential successor by the PRI Executive. In the end, the PRI's presidential candidate was appointed. One of the contenders, Cuahutémoc Cárdenas, quit the PRI to create his own party along with other Mexican parties from the left – the National Democratic Party (Partido de la Revolución Democrática, or PRD) – to participate in the presidential election. After a controversial and dubious election, Carlos Salinas de Gortari became President of Mexico in 1988.

The Political Implementation of Economic Adjustment: The Salinas Administration

The Salinas Administration once again mobilised the support from labour, business, and the public sector to initiate a new round of reforms. Salinas announced a new version of de la Madrid's PSE, called the Pact for Economic Stability and Growth (Pacto para la Estabilidad y el Crecimiento Económico, or PECE). This was another tripartite agreement signed on December 12, 1988, in which businesses and labour unions agreed to freeze prices and wages until July 31, 1989. In exchange, the Salinas Administration would prevent oil and electricity prices from increasing and peg the value of the peso to the U.S. dollar.[60] The PECE was renewed throughout 1991 and again extended until January 1993.[61]

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[60] Raul Trejo Delabre, *Los Mil Días de Carlos Salinas*, Mexico: El Nacional, p. 392.
[61] Organisation of Economic Cooperation and Development, *Mexico, Economic Survey Non-Members, 1991-1992*, OECD: Paris, 1993, p. 75.

Several international institutions, such as the World Bank and the Organisation of Economic Cooperation and Development, applauded the 'heterodox' strategies of the PSE of 1987 and its renewal through the PECE under Salinas's presidency. According to the World Bank, these social pacts were "a proper combination of orthodox and heterodox policies."[62] The OECD stated that:

> The transitory cost of the underlying shift towards a more rigorous anti-inflation monetary policy was greatly reduced by a comprehensive process of social concertation (including a flexible incomes policy), which prevented an excessive increase in real wages during the phase of rapid disinflation.[63]

In addition to the PECE, Salinas' presidency also implemented a major social policy program, the Program of National Solidarity (Programa Nacional de Solidaridad, or PRONASOL), which was intended to reduce the social discontent produced by the PECE and the privatisation of the *ejido*.[64] PRONASOL was a matching-grant program that required local participation in identifying and sponsoring small to medium-sized projects, rewarding communities for focusing on local agendas. Salinas claimed that PRONASOL marked a departure from previous policies of broad subsidies, high levels of unfocused government spending, and extensive state intervention in the economy.[65]

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[62] Daniel F. Oks, "Stabilization and Growth Recovery in Mexico, Lessons and Dilemmas," *World Bank Policy Research Working Papers Country Operations*, WPS 833, 1992, p. 3.

[63] Organisation of Economic Cooperation and Development, *Mexico,* p. 181.

[64] In 1992, Article 27 of the Mexican constitution was repealed. This article had protected communal land holdings from privatisation. The reform granted the communal land holders the rights to sell, rent, sharecrop, or mortgage their individual parcels or enter into joint ventures and contracts. Also, other policies were undertaken which tore down the foundations of the Mexican countryside, small-scale agricultural production and subsistence farming such reduction of inputs to the agricultural sector, removal of prices control, the state's elimination to imports and exports, etc. This left the peasantry with limited choices of survival such as entering the labour market in urban areas or migration to the U.S.

[65] Tim Campbell and Sara Freedheim, "PRONASOL in Principle: Basic Features and Significance of Mexico's Solidarity Program," *World Bank Latin America and the Caribbean Region Department Report 16,* Washington, 1994.

As mentioned, the PECE included the pegging of the Mexican peso to the American dollar within a floating band. The objective of the policy was to make the exchange rate "an anchor of the economy, signaling the government's commitment to adjust prices, wages, and public spending to maintain the stability of the exchange rate."[66] The initial annual rate of depreciation was 16 percent in 1988, and depreciation declined to only 2.5 percent in 1991.[67]

The process of privatisation was further pursued over the course of Salinas's period. Most public enterprises were sold, with the exception of few public companies such as the Federal Commission of Electricity and some industries of Mexican Petroleum (Petróleos Mexicanos, or PEMEX) among others. According to the Ministry of Finance, the process of privatisation was necessary in order to:

> [R]educe the [state's] unjustified expansion and eliminate superficial government intervention to deepen the structural change in the [Mexican] economy. Also, the adaptation of governmental processes to the new international context requires the implementation of incentives to individuals in the economy.[68]

By 1993, the government income obtained from the sale of public enterprises was 61.43 billion pesos. About 55 percent of the privatisation earnings came from the selling of commercial banks (See Figure 7). It is worth noting that nine of the 15 banks privatised between 1991 and 1992 were acquired by brokerage houses and that ownership in financial groups was highly concentrated in the 1990s.

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[66] Agustín Carstens, "Foreign Exchange and Monetary Policy in Mexico," *Columbia Journal of World Business,* 29, 1994, p. 75.
[67] Organisation of Economic Cooperation and Development, *Mexico,* p. 77.
[68] Secretaría de Hacienda y Crédito Público, *Desincorporación de Entidades Paraestatales, Información Básica de los Procesos del 11 de diciembre de 1988 al 31 de diciembre de 1993*, México: FCE, 1994, p. 8.

One family (or even an individual) could own more than 50 percent of the shares of a business group. It was not difficult, therefore, for an individual to bring together a group of investors, related to a specific business group, to invest in a bank. As such, financial groups with brokerage houses, credit card companies, and insurance companies were in a strong position to secure funds for their bid on Mexican banks.[69]

In order to privatise commercial banks, the Salinas administration had to change Article 28 of the Mexican constitution, removing the state's dominant role in the banking system and replacing it with private sector participation.[70] Likewise, the Salinas Administration implemented the Financial Groups Law in 1990. When the nationalisation of the banking sector took place, the Mexican state prohibited the constitution of financial groups and once again separated money from capital markets.

This new law, however, restored universal banking and created the legal framework that promoted the co-joining of industrial and banking firm ownership by financial groups. The new law authorised financial holding companies to head financial groups comprising banks, insurance companies, brokerage houses, and other financial institutions. Within this framework, groups could not include more than one of each type of financial institution except for mutual funds and insurance companies.[71]

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[69] Carlos Elizondo, *The Making of a New Alliance: The Privatisation of the Banks in Mexico,* Mexico: CIDE, 1993, p. 15.
[70] Secretaría de Hacienda y Crédito Público, *Desincorporación de Entidades Paraestatales*, p. 32.
[71] Organisation of Economic Cooperation and Development, *Mexico,* p. 176.

Figure 7. Banks Privatised by the Mexican Government, 1991-92

Name of the Bank	**Price (millions of pesos)**	**Purchasing Firm**
Multibanco Mercantil de México	61.1	Grupo Probursa
Banca Cremi	74.8	Grupo Multivalores
Banpaís	54.4	Grupo CBI
Banca Confía	89.2	Grupo Ábaco
Banco de Oriente	22.3	Individual investors
Banco de Crédito y Servicio	42.5	Grupo Alcántara
Banamex	974.0	Grupo Accival
Bancomer	779.0	Grupo Vamsa
Banco BCH	87.8	Grupo del Sureste
Banca Serfin	282.0	Grupo Obsa
Multibanco Comermex	270.0	Grupo Financiero Inverlat
Banco Mexicano Somex	262.0	Individual Investors
Banco del Atlántico	146.0	Grupo Bursátil Mexicano
Banca Promex	107.0	Individual Investors
Banoro	113.0	Grupo Esquer

Source: Secretaría de Hacienda y Crédito Público, *Desincorporación de Entidades Paraestatales,Información Básica de los Procesos del 11 de diciembre de 1988 al 31 de diciembre de 1993*, México: FCE, 1994.

This law also established that a bank could extend loans to a firm owned by a financial holding or by the members of the board of directors or major shareholders. The amount of this loan was limited to 20 percent of the total bank credits and could be granted at an interest rate below the market rate.[72] Foreigners were only allowed to own up to 30 percent of shares of banks and no more than 49 percent of non-banking financial institutions.

As part of the Salinas Administration strategy to restore investors' confidence in the Mexican economy, the Mexican and the American government reached an agreement on a long-term plan to restructure Mexico's 52.7 billion dollar debt owed to commercial creditors. The debt restructuring plan was designed to reduce Mexico's interest payments on its debt while reassuring investors that their principal and interests would be paid.[73] The Brady plan called for the write-off of bank debt under the voluntary conversion of the Mexican foreign debt into bonds collateralised by U.S. Treasury debt. Through this plan, holders could choose from a menu of Brady bond options – par, discount or new money bonds.[74] Discount bonds were to be exchanged against existing debt at a 35 percent discount. Par bonds were to be exchanged at par but carried a 6.25 percent fixed interest rate. New money bonds exchanged debt for money at LIBOR plus 13/16 with a

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[72] Sima Motamen-Samadian, "Economic Integration, Capital Flows and Financial Instability: The Case of Mexican Economy," in Christos Paraskevopoulos, et al. (eds.), *Global Financial Markets and Economic Development,* Toronto: Athenian Policy Forum, 2000, p. 229.

[73] Rosario Green, *Lecciones de la Deuda Externa de México*, Mexico: Fondo de Cultura Económica, 1997, pp. 341-7.

[74] Stijn Claessens and Sweder van Wijnbergen, "Secondary Market Prices and Mexico's Brady Deal," *The Quarterly Journal of Economics*, 18: 4, 1993, p. 968.

seven-year grace period and tenure of 15 years.[75] On the discount and par bonds, the debt's principal was fully secured. Banks choosing discount and par bonds could be paid 30 percent extra of oil revenues if the price rose above 14 U.S. dollars per barrel. Bank syndicates were expected to exchange Mexico's debt for any of the Brady bonds.[76] In 1990, Mexico became the first country to issue Brady bonds, converting 48.1 billion dollars of its eligible foreign debt. As a result, Mexico's external debt was reduced from approximately 100 billion dollars in 1988 to an equivalent of about 85.8 billion dollars in 1990 (See Figure 8).[77]

The PECE, the crawling exchange rate regime, the privatisation of banks, and the Brady plan fostered investors' confidence in the peso. "By 1991, Mexico accounted for 90 percent of the volume of total Latin American international bond issues."[78] Foreign investment in government securities grew by 756 percent between 1991 and August 1994.[79] Likewise, the major financial companies were able to grow more rapidly than the total GDP until 1995 (See Figure 9). The state's reassurance of the strength of Mexico's capital markets to investors was further reinforced with the prospect of the NAFTA. Investment flowed into Mexico, first in the form of direct investment, and then increasingly in the form of portfolio investment.[80]

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[75] LIBOR stands for London Inter-Bank Offered Rate, that is the average interest rate that London banks charge on Eurodollar loans as they lend to one another

[76] Claessens and Wijnbergen, "Secondary Market Prices and Mexico's Brady Deal," p. 959.

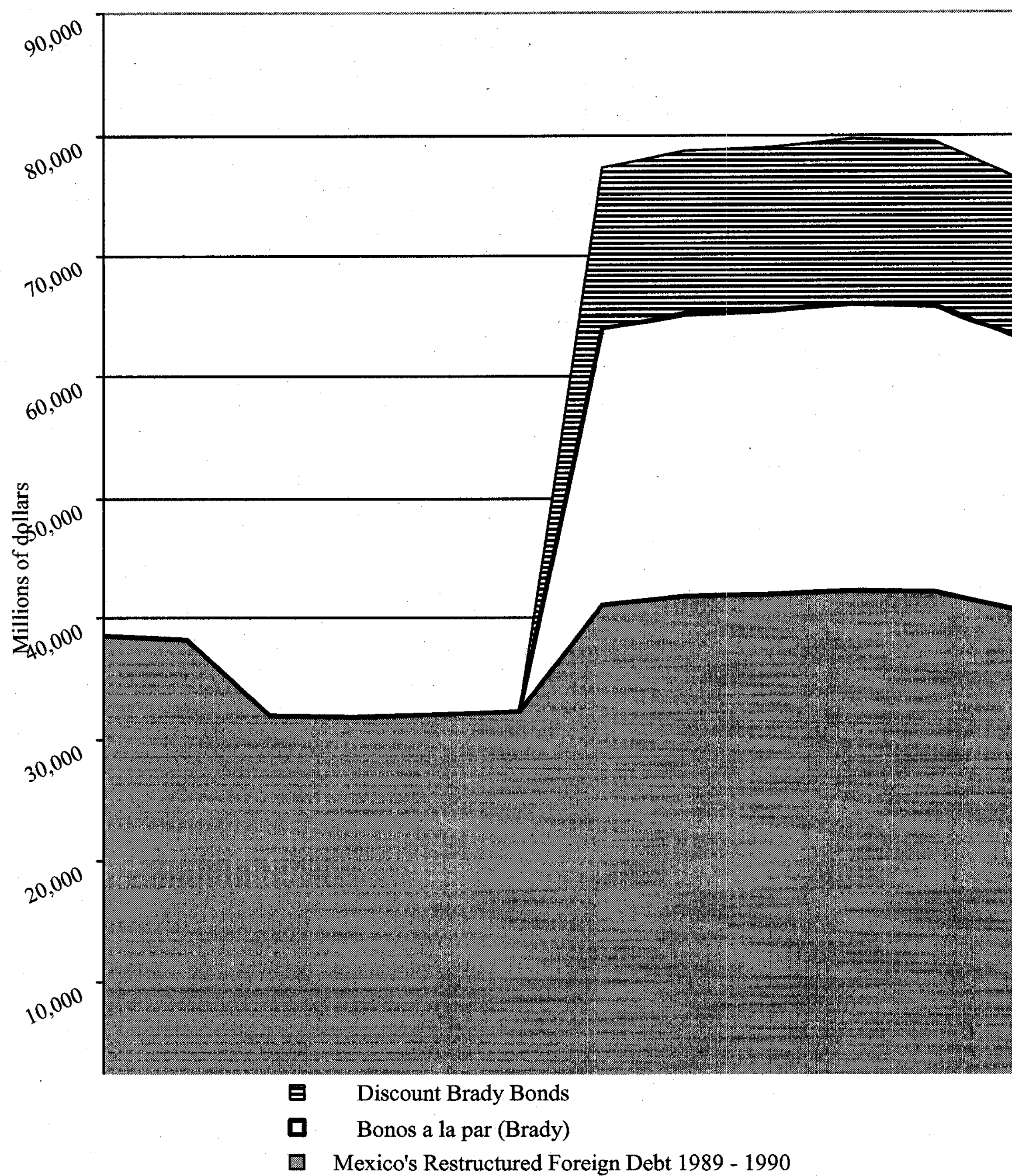
[77] Robert Pastor, *Integration with Mexico: Options for U.S. Policy*, New York. Brooking & the Twentieth Century Fund, 1993, p. 19.

[78] Timothy Kessler, "Political Capital: Mexican Financial Policy under Salinas," *World Politics* 51: 1, 1998, p. 61.

[79] Anonymous, *Mercado de Valores*, 1994, p. 31 quoted in Kessler, "Political Capital: Mexican Financial Policy under Salinas," p. 51.

[80] Henry Selby, "Introduction: The Economic and Political Crisis in Mexico," in Henry Selby and Harley Browning (eds.), *The Sociodemographic Effects of the Crisis in Mexico,* Austin: UT Austin, 1992, p. 59.

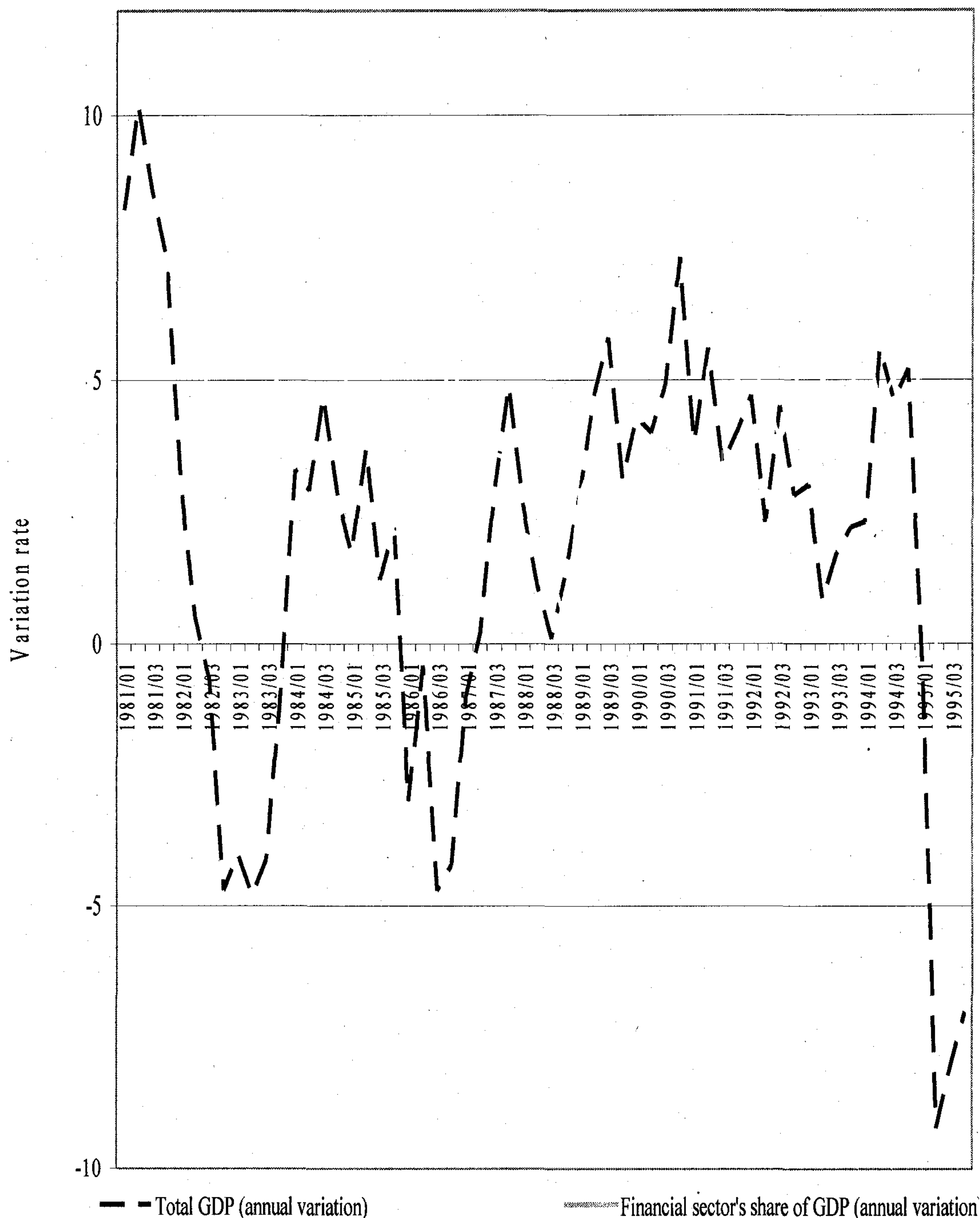
Figure 8. Mexico's Brady Bonds, 1989-1990 (millions of dollars)



c.

Source: Secretaria de Hacienda y Crédito Público, *Deuda Externa del Sector Público*, Mexico, 1990.

Figure 9. Annual Variation of the Mexican GDP and Financial Activities



Source: INEGI, *Banco de Información Económica*, Mexico, 2006.

Class, the Mexican State, and the Debt Crisis

The notion of the Mexican state as a historical subject is pivotal to understanding how the state is differentially penetrated by conflicting classes, while incorporating and reflecting the struggle between them. The territoriality of the state is also central in the process of the internationalisation of capital, since the former sets the conditions for global accumulation, particularly through the production of geographical differentials such as interest rates, exchange rates, and monetary policy. The emergence of an internal bourgeoisie holds a very important role in the process of internationalisation of the Mexican economy.

Internationalisation is partly fostered by this internal bourgeoisie because this process strengthens this class ability to operate at the international scale without depending entirely on capitalist power from industrialised countries. A concept such as that of an internal bourgeoisie is useful to explain how the internal class configuration in Mexico, and the form of the state, has determined the ways in which the Mexican economy and the capitalist class articulate themselves to global accumulation.

Arguments that see the Luis Echeverría (1970-1976) and José López Portillo (1976-1982) Administrations as economic periods that operated against the interests of private sector and financial activities ignore the fact that, despite the highly interventionist nature of their governments, the policies of their administrations accelerated the internationalisation of the Mexican economy.[81] During this period, the Mexican state intensified the territorial differentials that drove Mexican and worldwide

[81] Anonymous, "PRIde before the fall," *The Economist*, 26 October 2000.

financial markets. More specifically, the high interest rates set by the Mexican government gave investors an incentive to hold pesos. This occurred in a context where bond yields in U.S. dollars were low.[82] Loans in dollars were not only driven by differential interest rates but also by stability in the worthiness of the peso. The latter, of course, was guaranteed by the high volume of foreign borrowing secured by oil exports.

The Mexican state also encouraged deposits in dollars within Mexico at high interest rates in order to increase the banks deposits that would eventually serve as a credit source for state financing between 1970 and 1982. However, the proliferation of dollar assets and liabilities in Mexican banks increased the obligations on the Mexican central bank to cover these dollar transactions.[83] As such, the territoriality of the Mexican state was pivotal in supporting the geographical differentials of high interest rates, the high value of the peso, and the foreign borrowing that shaped the international markets of petrodollars and the articulation of the Mexican economy to the processes of capital internationalisation.

These state policies provided the conditions for the articulation of a Mexican internal bourgeoisie to international accumulation. The Mexican internal bourgeoisie had vested interests in further internationalising the Mexican economy since this enhanced their position within the Mexican class structure. The legal reforms for financial groups and universal banking of the 1970s not only created the conditions to link different economic activities under the control of one company, but also allowed for a further articulation of the Mexican economy to the international socialisation of capital. In other

[82] Tello, *La Nacionalización de la Banca en Mexico*, Mexico: Siglo XXI, 1984, p. 51.
[83] Ibid., p. 64.

words, while the markets and production were located within Mexico, they remained international because of their relationship with the controlling bank of the financial group. In this case, the controlling bank would withdraw profits from a nationally located production process and amalgamate it with other capitals internationally through financial markets. Nationally constrained activities could still be international since their reproduction relied on international finance.

Speculation on currency devaluation due to the volatility of oil prices and the existence of 'Mexdollars' set the conditions to profit from foreign exchange operations. Banks were particularly well-positioned, since profits from dollar and peso exchanges represented about a third of their total revenues.[84] It had become quite lucrative for Mexican banks to profit from geographical differentials in the form of exchange rates and interest rates.

The Mexican internal bourgeoisie greatly benefited from state policies of high interest rates, exchange rate stability, 'dollarisation' of bank accounts and the increased borrowing of the Mexican state. The internal bourgeoisie, which crystallised into financial groups, profited from interest rates differentials between Mexico and other countries such as the United States. In other words, financial groups borrowed in dollars, due to low interest rates in the market and invested these loans in peso deposits that had high returns.

The state policy of foreign borrowing also assisted in the further articulation of the Mexican economy to the process of internationalisation *via* financial markets. On the

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[84] By 1982, 29 percent of Banamex's profits were dependant on foreign exchange operations. See: White, *State, Class and the Nationalization of the Mexican Banks,* p. 88.

one hand, the Mexican state increased the leverage of international bank syndicates because of their reliance on foreign borrowing by the state to cover financial obligations in dollars within Mexico. Mexican banks, on the other hand, had shares in these syndicates.[85] Mexico's three largest banks – Bancomer, Banamex and Serfin – had been participating in Euromarket operations since 1971 through syndicated banks.[86]

The Mexican internal bourgeoisie, therefore, had more interest in lending to the Mexican government than their international counterparts in the syndicated banks. Mexican banks received interest from the loans acquired by the Mexican government. These same banks also held accounts in 'Mexdollars' and carried loans in foreign currencies. Meanwhile, these dollar loans and deposits within the Mexican banking system were foreign currency obligations that the central bank had to cover. In order to back these dollar obligations, the Mexican central bank required more dollar loans from the international syndicated banks.[87] In this way, Mexican banks, through bank syndicates, could profit simultaneously from currency speculation and interests on the loans provided to the Mexican state.

The loans of the syndicated banks, therefore, coincided with the longer term interests of the internal bourgeoisie by taking advantage of its access to international loans, often through its intimate connection to the state apparatus. The Mexican capitalist class was not merely an intermediary of 'foreign capital' or a victim of the state's

[85] Tello, *La Nacionalización de la Banca en Mexico,* p. 32.
[86] Bancomer was part of Libra Bank, Serfin was part of Euro Latin American Bank, and Banamex was part of the Inter Mexican bank consortium. Banamex had 36.25 percent of the shares, Bank of America had 27.5 percent, Deutsche Bank owned 14.5 percent of the consortium and Dai Ichi Bank owned 7.25 percent. See: White, *State, Class and the Nationalization of the Mexican Banks*, p. 91.
[87] Tello, *La Nacionalización de la Banca en Mexico*, p. 32.

interventionist policies. Rather, the Mexican capitalist class was an active force in fostering, along with the state, the articulation of the Mexican economy to the world market *via* financial markets during the 1970s and the early 1980s. This had repercussions over capitalist social relations in Mexico as a whole.

In order to understand these consequences, it is important to reiterate that internationalisation of capital in the Mexican context does not solely refer to the increase of international financial transactions by Mexican firms or the state's foreign borrowing. Rather, internationalisation refers to the ways in which the capital relation has expanded within Mexico to sustain the international operations of Mexican financial groups and public external indebtedness. This process was upheld within the Mexican nation-state by the expansion of the wage relation and the downward compression of salaries. By 1980, Mexican workers' real wages had decreased by 50 percent.[88] Wages and employment were not only more dependent on sales in domestic and international markets by Mexican companies, but also were increasingly exposed to international financial markets due to the organisation of the economy around financial groups and Mexican banks. Mexican firms needed to continue obtaining profits based on wage reduction in Mexico either to pay for bank loans granted by Mexican banks (e.g. Mexdollars, Euromarket) or/and guarantee their international reproduction by investing in international syndicated banks.

It is worth noting that the policies of the Mexican state were not the result of the logic of capital or of the state acting on behalf of the internal bourgeoisie. Rather, state

[88] Antonio Rojas Nieto, "Implicaciones Sociales de la Estrategia Económica-Social," en Pablo González Casanova y Hector Aguilar Camín (eds.), *México ante la Crisis,* México: Siglo XXI, 1982, p. 22.

economic policies in the years prior to the debt crisis reflected the balance of social forces at the time. On the one hand, financial groups were represented in the administration board of the central bank. The Finance Ministry in many cases consulted with the Mexican Association of Bankers on laws and mechanisms that they proposed.[89] Labour and the peasantry (or at least its leaders), on the other hand, were part of the PRI's corporatist structure and were important to the reproduction of state structures and the stabilisation of class conflict.

Mexico's financial policy of high interest rates, reliance on oil revenues, heavy state borrowing, and currency stability, therefore, mediated conflict between these forces. The state attempted to promote social investment and satisfy social demands through the provision of employment opportunities and social programs.[90] As such, increasing borrowing allowed the state to satisfy the internal market's needs for dollars and to enrich Mexican banks that were part of international bank syndicates. Throughout the 1981-82 crisis, the Mexican state obtained large amounts of short-term loans from international bank syndicates. The Mexican state, however, did not use most of these loans on social programs or consumption subsidies. Rather, large amounts of debt were employed to purchase pesos under circumstances of an excess demand in dollars. While the Mexican state made available 64.4 percent of the dollars circulating within Mexico, it only channelled 35.1 percent of the dollar loans into public spending.[91] This measure was carried out by the Mexican central bank in order to maintain the worthiness of the peso,

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[89] Tello, *La Nacionalización de la Banca en Mexico,* p. 54.
[90] White, *State, Class and the Nationalization of the Mexican Banks*, pp. 83-4.
[91] James Cypher, *Estado y Capital en Mexico*, Mexico: Siglo XXI, 1992, p. 157.

on the one hand, and to supply with the dollars necessary to pay for the private sector's deposits in 'Mexdollars,' on the other. The availability of foreign currency to the private sector allowed the internal bourgeoisie to convert their assets into dollars before the 1981 and 1982 devaluations. This was particularly advantageous to the internal bourgeoisie since this isolated them from the domestic economic restructuring that was to follow.

Policies regarding 'Mexdollar' deposits reflected the class struggle within the Mexican power bloc, particularly during the 1982 debt crisis. Initially, the Mexican state adopted a dual parity exchange system *vis-à-vis* the U.S. dollar. A preferential exchange rate was established to pay private and public interests on foreign debt and to import goods authorised by the Ministry of Commerce. The prevailing exchange rate was left to the mechanism of supply and demand. On August 2, 1982, the Central Bank and the Finance Ministry made reforms that stipulated that bank deposits in dollars had to be paid in national currency at the prevailing exchange rate. As Russell White notes, there were conflicting interests involved in the dual parity system and the withdrawal of 'Mexdollars' from Mexican banks:

> An interesting contradiction had developed. The Finance Secretary announced a dual exchange market and noted that free exchange would be maintained. Meanwhile, the central bank noted that banks should not alter the way foreign denominated accounts were treated ... Although the Finance Secretary had prefaced his announcement of a dual exchange rate with the declaration that the free exchange market will be maintained, the central bank reminded banks to pay foreign denominated accounts in foreign currency.[92]

The central bank's policies reflected the balance of forces that favoured those classes that benefited from capital flight. As a result, the central bank encouraged deposits in foreign

[92] White, *State, Class and the Nationalization of the Mexican Banks,* p. 112.

denominated currency within Mexico, reinitiating speculation on the Mexican peso. The Mexican state clearly influenced the way in which the internal bourgeoisie became articulated to international crossing of capitals by profiting from geographical discontinuities in financial markets in the form of monetary and fiscal policies.

The Mexican state reduced its budget while increasing the prices of public services. This occurred without a proportionate increase in wages. Protests and labour strikes ensued while capital flight continued despite a series of policies of devaluation, controlled exchange rates, and high interest rates implemented by the state to keep capital within Mexico's borders. The historical tensions and struggles within and between the state and competing class actors influenced the state decision to nationalise banks in September of 1982. Indeed, this decision called into question the hegemony of finance capital, including its control over universal banking and several economic activities, and accentuated the political struggle within the power bloc over Mexico's development strategy. In the long run, nationalisation became only an attempt to rescue the financial system from bankruptcy than a structural change in economic policy *vis- à-vis* private banks. Nationalisation momentarily diminished the hegemonic position of finance capital within the bloc that held state power, a position that this faction had consolidated during the 1970s. Financial capital, however, regained its hegemonic position was months after the nationalisation of banks when the De la Madrid Administration facilitated the resurgence of the financial capital within the power bloc, thereby preparing the way for further internationalisation of the Mexican economy *via* financial markets.

As a whole, the debt crisis also expressed the deeper contradictions within the international realm of accumulation and the national scale of state regulation. On the one hand, the internal bourgeoisie and the reproduction of capitalist relations in Mexico became increasingly dependent on its integration to the international circuit of capital through financial markets. On the other hand, the very articulation of the internal bourgeoisie and the Mexican economy to international accumulation was shaped by the territoriality of the Mexican state, particularly through monetary policies of high interest rates, foreign borrowing and low wages.

The De La Madrid and Salinas Years: The Recomposition of Class Relations

Right after the debt crisis, the IMF imposed policies of public spending reduction and low inflation in Mexico. Yet, the way these policies were pursued internally was shaped by the balance of forces within the power bloc and the PRI's corporatist structure. This was expressed in FICORCA and the subsequent tripartite economic pacts. The FICORCA led to the restoration of the state's relationship with domestic businesses after bank nationalisation and became one of the state's strategies to socialise private debt.[93] Mexicans located within social positions delinked from the benefits of financial markets, such as the middle class, workers, and peasants, had to pay for the difference between the real exchange rate and the preferential exchange rate.

Additionally, the several *pactos* reflected the political structure within the PRI – t that is, the state's incorporation of labour and peasant organisations into the government.

[93] Blanca Heredia, "State-business Relations in Contemporary Mexico," in Monica Serrano and Victor Bulmer-Thomas (eds.), *Rebuilding the State: Mexico after Salinas*, London: Institute of Latin American Studies, 1995, p. 136.

The social accords contained the potential unrest that anti-inflationary policies, based on price increases and wage reduction, could instigate. More specifically, the Executive's cooptation of labour and peasant leaders, as well as the latter's influence over the members of their organisations, provided the support of the economic restructuring. In this respect, Aspe Armella points outs that the pacts were "set in motion without the help of the International Monetary Fund."[94] The *pactos*, the PSE and the PECE in particular, created the institutional framework to formulate *ad hoc* anti-inflationary policies based on wage controls. The continuation of these policies depended, therefore, on the political power of official unions, and ultimately on the class struggle. In this way, economic policy remained highly politicised.

The nationalisation of banks also facilitated the austerity adjustment adopted under the De la Madrid Administration. De la Madrid did not dismantle the nationalised banking system immediately and instead created a parallel financial circuit. De la Madrid only privatised non-banking financial institutions such as brokerage houses and kept hold of the banks. This became profitable for private firms because of developments in international capital markets and public debt. The appropriation of brokerage houses and insurance companies by the private sector allowed them to become involved in the development and control of capital markets. These bankers further benefited from the expansion of the stock market operations and the issuing of public bonds that resulted from the constant need to refinance the public deficit and the capitalisation of

[94] Aspe Armella, *Economic Transformation: The Mexican Way*, p. 34.

nationalised banks. In this way, the Mexican state facilitated the reorganisation of the Mexican capitalist class through the partial privatisation of the Mexican financial system.

The Mexican state also altered the configuration of Mexico's capitalist class through the partial privatisation of the financial system, since new private groups were able to purchase non-banking financial institutions. These groups, prior to 1982, were non-existent or had a limited role in the economy. Privatisation provided the conditions for an emerging capitalist class to participate in the operations of non-banking financial institutions.[95] The appropriation of brokerage houses and insurance companies by former bankers and new owners allowed them to become involved in the development and control of capital markets.[96] These bankers further benefited from the expansion of the stock market and state debt operations.

The issuing of public bonds that resulted from the constant need to refinance the public deficit and the capitalisation of nationalised banks were the primary factors driving the expansion of the Mexican financial sector. Capital markets became even more attractive for investors when the Mexican state raised interest rates to facilitate the placement of public securities in private capital markets. As a result of bank nationalisation and the sale of non-banking financial institutions, power relations within business and within the state apparatus experienced major alterations. This entailed a

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[95] This is the case of Grupo Carso, which includes the former public owned phone company Telmex, Inbursa Investment Bank, Inbursa Brokerage House, Seguros de Mexico Insurance Company. See: Carlos Morera Camacho, "Transnacionalización de los Grupos de Capital Financiero en México: Límites y Contradicciones," en Julio Gambina (ed.), *La Globalización Económica Financiera: su Impacto en América Latina*, Buenos Aires, CLACSO, 2002.

[96] White, *State, Class and the Nationalization of the Mexican Banks,* p. 110.

recomposition of the class configuration in Mexico, particularly of the internal bourgeoisie.[97]

The ownership and control over Mexican banks by the state shaped and influenced the competition environment and the structure of the internal bourgeoisie and the Mexican financial sector. In particular, the elimination and merging of several banks by the state policies during De la Madrid's presidency concentrated the organisation of the nationalised financial system into a few banks. The concentration of the banking system and the favourable legal framework allowed banks to increase the total level of loans beyond the acceptable level compatible with capital adequacy margins. Even though the new legislation limited the amount of money that a bank could give to a firm owned by a financial group or by the members of the board of directors, the board members had a vested interest in allowing the banks to increase credit to borrowers. This, in turn, enabled the financial group to acquire a higher amount of cheap credit that represented the established 20 percent of the total bank credits.[98] These lending practices increased the power of financial groups within the Mexican economy. In the new context of the 1980s, this also meant that the role of the Mexico's internal bourgeoisie was as a central actor in the process of internationalisation of the Mexican economy.[99]

The restructuring of the Mexican economy reopened international credit to bolster Mexico's state finance. This was a significant accomplishment of the Brady plan.

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[97] Heredia, "State-business Relations in Contemporary Mexico," p. 138.

[98] Before the crisis, both Banamex and Bancomer had a combined market share of over 50 percent in banking sector. Banamex had 135 billion pesos worth of assets (22 percent of the total banking system) and 700 branches. Bancomer, on the other hand, had assets of 110 billion pesos (21percent of the total banking system) and 831 branches. Danielle Robinson, "Mexico's Big Two Fight for Dominance," *Euromoney,* September, 1994, p. 89.

[99] Elizondo, *The Making of a New Alliance*, pp. 15-7.

Through the Brady bonds, debt was securitised and became more liquid than commercial banks loans, allowing for a fragmentation of sovereign debt, redistributing credit risk and setting the basis for the growth of more sophisticated financial instruments.[100] The renegotiation of sovereign debt through Brady bonds shows that the Mexican state was crucial in implementing measures to fragment debt, accelerating the circulation of capital through finance, and promoting the sophistication of financial markets.

The combination of the 1980s banking reforms and the creation of the Brady bonds strengthened the internal bourgeoisie and its internal alliance within the power bloc. The owners of the newly privatised banks, for example, represented an influential constituency favouring a strong peso. They provided the PRI with the political support for reform and major financial contributions, while the Salinas administration provided them with a strong peso, high interest rates and protection from competition.[101]

The Consolidation of Neoliberalism in Mexico

The ascendancy of neoliberalism took place in the aftermath of the debt crisis of 1982 and became consolidated throughout the 1990s when the state disciplined capitalist social relations and dismantled institutions and policy tools that accommodated subordinated social classes within the state. The debt crisis thus facilitated the implementation of neoliberal restructuring, since it meant a disciplining of labour relations. Both De la Madrid's and Salinas's presidencies also used the conditionalities of IMF loans to restructure the economy in such a way that it benefited financial markets

[100] While sovereign debtors held exchange and interest rate risk, bank syndicates had the credit risk.
[101] Timothy Kessler, "The Mexican Peso Crash: Causes, Consequences and Comeback," in Carol Wise and Riordan Roett (eds.), *Exchange Rate Politics in Latin America,* Washington: Brookings Institution, 2000, p. 50.

and the Mexican national bourgeoisie. The implementation of these conditionalities could be justified by international organisations urging for structural reforms such as privatisation and anti-inflationary measures on the Mexican state. These reforms restrained the demands of labour in order to guarantee the accumulation within the national circuit of capital. The logic of state restructuring was clear: the profitability of privatisation of the financial system and the Brady bonds would be guaranteed by a reduction in wages, the imposition of flexible working conditions, and strict control over public budget. While these policies constrained capital's profitability temporarily, the long-term effects – downward pressure on wages, higher prices on basic necessities, and reductions in social spending – could be felt by Mexican workers for some time as a major political defeat.

De la Madrid's and Salinas' presidencies described economic restructuring as an external pressure of international financial organisations and global markets. This served to depoliticise the domestic forces and imperatives that were causing these economic changes. The externalisation of the imperatives of economic restructuring helped break down traditional discourses and institutional mechanisms inside the Mexican state through which different classes, particularly labour, permeated economic decision-making. From the foundation of the PRI in the Calles's period to the López Portillo Administration, the corporatist structure within the 'official party' allowed union leaders of workers' and peasants' organisations to be part of the power bloc. While these leaders might have minimally pursued labour and agrarian reforms in favour of subordinated classes out of principle, they had to incorporate some of the demands of their class

members within the PRI to guarantee their control over subordinated classes. Control over memberships provided union leaders with a bargaining chip that permitted the reproduction of their position within the power bloc.[102] Although this mechanism lacked democratic mechanisms for popular participation, Mexican corporatism became the main vehicle for the inclusion of the economic demands of subordinated classes in the state agenda.[103] The petitions for wage increases and price reductions during Echeverría's administration are examples of these mechanisms.

While De la Madrid's administration left intact the corporatist structure of the PRI in order to carry out the structural reforms, Salinas' administration undertook the more severe transformation of the internal structure of the PRI. PRONASOL replaced the corporatist practices within the PRI as the main direct mechanism of social control. PRONASOL became influential in dispersing rural communities and workers' support from the PRI peasants and workers organisations. The PRONASOL established a structure of incentives, which rewarded rural communities and workers for focusing on local infrastructural projects, such as paved roads, sewage, and electricity, and discouraged them from placing emphasis on national economic issues within the corporatist organisations of the PRI. As such, social discontent could be channelled to more individualised and specific social demands through the PRONASOL, which became a mechanism to achieve consensus and support of the subordinated classes for economic restructuring. The effectiveness of PRONASOL in withdrawing support from

[102] Clarissa Hardy, *El Estado y los Campesinos: la Confederación Nacional Campesina*, Mexico: Nueva Imagen/CEESTEM, 1984, p.51.

[103] See: Viviana Patroni, "The Decline and Fall of Corporatism? Labour Legislation Reform in Mexico and Argentina during the 1990s," *Canadian Journal of Political Science,* 34: 2, 2001.

the workers' and peasants' organisations of the PRI meant that these corporatist institutions could no longer intervene in economic policy, as in previous presidential administrations. The traditional corporatist structure of the PRI was gradually dismantled. State policies such as PRONASOL show how mechanisms of consensus and coercion within the state have influenced the ways in which finance is reproduced and economic restructuring is implemented within Mexico, intensifying the process of internationalisation of the Mexican economy.

The implementation of neoliberalism was further consolidated by Salinas's economic policy of packaging sovereign debt. The Brady bonds closely tied the Mexican economy to international norms of profitability. The packaging of Mexico's sovereign debt as a new investment instrument to hedge risk subjected the performance of the Mexican economy, including workers' productivity, low costs, and currency strength, to international valuation. The Brady bonds offered high returns as long as Mexico's economic performance was considered rewarding for investors. If not, economic discipline had to be imposed on Mexican workers and peasants through state policies in order to make the sovereign debt attractive for investors. The consolidation of neoliberalism in Mexico was not the primacy of a particular ideology or set of policies, but rather the political construction of market discipline on social relations through the Mexican state. In this case, market discipline was implemented through the state's weakening of the traditional structures of the PRI and the subjection of the Mexican economy to the profitable rates set by Brady bonds.

Conclusion

In the Mexican literature on globalisation, the processes of internationalisation are seen either as the outcome of state adaptation to economic and technological imperatives of global markets or as the result of the IMF's, international banks', and the American state's external imposition of economic reforms on Mexico. These interpretations are problematic. They leave unexplained the internal class relations in Mexico, the manifestation of this struggle in the state, and the role of state territoriality in changing class relations.

Conversely, this chapter has discussed how the capitalist class and the dominant social relations that compose capitalism within Mexico remain located within the territoriality of the Mexican nation-state despite the articulation of the Mexican economy to international accumulation. The analysis of the national class processes that took place during the neoliberal reforms of the 1980s and 1990s shows that state territoriality has transformed and reproduced the role of finance within Mexico and internalised market discipline *via* neoliberal policies. The implementation of neoliberalism in Mexico has also altered the class configuration within Mexico, influenced the articulation of the internal bourgeoisie to international accumulation and determined the ways in which financial capital has reasserted itself within the Mexican power bloc.

Chapter 5

Finance and the Consolidation of State Restructuring in Mexico

Several analysts often cite dramatic changes in international financial markets over the last two decades as the cause of the inability of the state, particularly central banks, to guide the economy. These debates most often see state economic interventions in the form of neoliberal policies as functions imposed by the necessities of production and globalisation. Such explanations are often invoked for the role of the Mexican state in the 1990s peso crisis. These discussions, however, fail to explain why economic interventions continue to have the Mexican nation-state at its centre despite the internationalisation of capital. The primary concern remains why and how the Mexican state is able to internalise the imperatives of financial markets within Mexico at the expense of labour. This chapter argues that the internationalisation of Mexican economy fostered by the Mexican state has also entailed transformations of the state apparatus. These transformations have resulted in the parallel consolidation of anti-inflationary policies and the locking-in of these policies into state agencies insulated from popular pressures. This is the case of the independence of the Mexican central bank.

This chapter first discusses several interpretations of the changing role of the Mexican central bank. Second, the chapter presents an overview of the economic policies in Mexico prior to the Mexican peso crisis and the subsequent changes in monetary policy. Third, the chapter examines the ways in which the Mexican state has depoliticised economic decision-making through increasing the autonomy of the central

bank so as to institutionalise anti-inflationary policies that insulate economic policy from societal demands.

The Mexican Central Bank

Economic rationalists have emphasised the need for central bank independence in Mexico.[1] Within this framework, inflation is seen as the outcome of the Mexican government's lack of commitment to the announced inflation objective and high levels of government spending during the 1970s and 1980s. Eduardo Turrent Díaz argues that the concentration of power in the Executive was one of the main causes that led to expansionary spending policies.[2] This perspective suggests that the large government spending of the 1970s and early 1980s to finance 'populist policies' was carried out at the expense of price stability.[3] It is suggested that the main driving force behind Mexico's central bank autonomy was the desire to signal to markets the government's commitment to price stability, expressing the political and social consensus to eradicate inflation.[4] Central bank independence is regarded as a mechanism to guarantee that anti-inflationary policies would "transcend individuals and transform themselves into institutions."[5]

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[1] See: Agustín Carstens and Luis Jácome, "La Reforma de los Bancos Centrales Latinoamericanos," *El Trimestre Económico*, 72, 2005.

[2] Eduardo Turrent Díaz, "Las Tres Etapas de Autonomía del Banco Central de México," *Análisis Económico*, 20: 43, 2005, p. 76.

[3] Guillermo Ortiz Martínez, "Central Bank Perspectives on Stabilization Policy," *Federal Reserve Bank of Kansas City Economic Review*, 4, 2002.

[4] Luis Aguilar Villanueva, "Reformas y Retos de la Administración Pública," *Foro Internacional*, 36, 1-2, 1996, p. 206; Federico Rublo Keiser, "Autonomía del Banco Central Bajo Tensión Financiera: Experiencia Reciente de Mexico," *Centro de Estudios Monetarios Cuadernos de Investigación,* 36, *1996,* p.29.

[5] Pedro Aspe Armella, *Iniciativa de Reforma Constitucional para Dotar de Autonomía al Banco de México*, Address to the Mexican Chamber of Deputies, 24 May 1993; Comité Latinoamericano de Asuntos Financieros, *Independencia del Banco Central, la Opción Acertada para Latinoamérica, Declaración n. 4*, Montevideo, Uruguay, 18 October 2001.

Federico Rublo Keiser argues that the effectiveness of Mexico's central bank autonomy was particularly evident during the peso crisis. He considers that BANXICO's autonomy prevented the government from carrying out economic solutions involving public spending and less visible political costs. Instead, the Mexican central bank was able to implement unpopular policies to achieve price stability because of its independence.[6]

In contrast, neo-Weberian debates focus on the degree of autonomy of the Mexican central bank and argue that the Bank of Mexico is not entirely autonomous. Guadalupe Mántey contends that central bank autonomy must entail a bank's commitment to increase the circulation of money in accordance with price stability objectives. To do so, the central bank needs to manage government credit, decrease its international reserves and tighten credit supply by increasing interest rates while decreasing yields in government bonds.[7] According to Mántey, central bank management did not occur in Mexico. Guillermo Calvo and Enrique Mendoza point out that the Mexican central bank indirectly subsidised commercial banks through high interest rates in government bonds and large credit supply to commercial banks at low rates, contributing to the loss of reserves that preceded the peso crisis.[8] This perspective suggests that Mexican central bank autonomy did not guarantee the implementation of

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[6] Rublo Keiser, "Autonomía del Banco Central Bajo Tensión Financiera: Experiencia Reciente de Mexico," p. 9.

[7] Guadalupe Mántey, "Efectos de la Liberalización Financiera en la Deuda Pública de México," Alicia Girón y Eugenia Correa, *Crisis Financiera, Mercado sin Fronteras*, Mexico: Ediciones El Caballito, 1997, p. 253.

[8] Guadalupe Mántey, "Efectos de la Liberalización Financiera en la Deuda Pública de México," pp. 254-5.

price stability policies through the tightening of the supply of credit.[9] Instead, the Mexican central bank implemented expansionary policies.

Marxist interpretations have focused on the inability of the Mexican state, particularly the central bank, to deal with the mobility of financial capital and the power of the private sector, particularly after the collapse of the Mexican financial system in 1994-95. This inability is also seen as the expression of the loss of Mexico's sovereignty over its own economic policy.[10] As such, the Mexican central bank is seen as having a limited role in coördinating the national economy.

The various views that discuss the autonomy of the central bank fail to explain how and why the Mexican state is able to isolate economic policy. Arguments that look at central bank autonomy as the loss of national control over economic policy cannot explain why the Mexican state has remained central to guiding the economy and maintaining the worthiness of the Mexican peso. In contrast, analyses that begin from the premise that central bank independence is a means to depoliticise economic policy hint at relevant aspects of the role of the state apparatus in the context of economic internationalisation. Still, all these debates fail to question the effects that central bank independence has over democratic participation in economic decision-making.

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[9] Guillermo Calvo y Enrique Mendoza, "La Crisis de la Balanza de Pagos de México," *Investigación Económica*, 219, 1997, pp. 17-23.

[10] Irma Manrique Campos, "América Latina: Reestructuración Financiera y Autonomía de la Banca Central," *Problemas del Desarrollo*, 25: 99, 1994, p. 173-4; Arturo Huerta, "La Autonomía del Banco Central y la Pérdida de Manejo Soberano de Política Económica," en Eugenia Correa y Alicia Girón (eds.), *Reforma Financiera en América Latina*, Buenos Aires: CLACSO, 2006, p. 66. See also: Jesús Lechuga Montenegro, "Acumulación y Regulación en la Economía Mexicana," *Problemas del Desarrollo*, 32, 125, 2001, p. 78.

Implicit in these discussions is the desirability of inflation controls based on low wages. These views presume that inflation is the consequence of the excess of money coming from wages and workers' consumption. Capitalists, as suggested in these views, have a high tendency to save their income rather than consume it.[11] Such notions of inflation ignore that labour has also become the focus of monetary policy for reasons beyond these assumptions about inflation. Low wages have been placed at the centre of BANXICO's monetary policy because it is the most important transmission mechanism of global discipline to national economic conditions.[12] Within an anti-inflationary framework, any decline in national competitiveness relative to other economies is expressed through high unemployment rather than an increase in inflation and a fall in the Mexican peso. Also, low labour costs guarantee production, which secures the realisation of profits in capital markets. In this way, targeting labour becomes the way in which the Mexican state mediates the contradictions among capitals, and between the international nature of accumulation and the national regulation of capitalism.

The institutionalisation of price stability within depoliticised economic management and autonomous state institutions, such as independent central banks, remains a governing strategy, and therefore, it continues to be highly political.[13] This strategy consists of maintaining the Executive's control over crucial economic processes

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[11] Jonathan Nitzan and Shimshon Bichler, *The Global Political Economy of Israel*, London: Pluto Press, 2002, p. 153.
[12] Dick Bryan, *The Chase Across the Globe: International Accumulation and the Contradictions for Nation-State,* Boulder: Westview Press, 1995, p. 162.
[13] Peter Burnham, "The Politics of Economic Management in the 1990s," *New Political Economy*, 4:1, 1999, p. 47.

while benefiting from the distancing of conflicts in partisan politics and direct participation of society.

The autonomy of BANXICO also entails the transformation of the social power of capital into political authority. This does not refer to the manipulation of the central bank by capitalists to subsidise their profits or maintain a competitive position. Rather, this transformation refers to the role of the central bank in upholding the conditions under which the pursuit of profit for private investment continues. Since monetary policy helps determine the distribution of wealth, the central bank remains responsible for reinforcing patterns of exclusion. By depoliticising and isolating economic management, the Mexican state avoids responsibility for the social consequences caused by the asymmetric distribution of income and wealth arising from anti-inflationary policies.

The Changing Role of the Mexican Central Bank

The Mexican state has undertaken major changes in monetary policy and financial regulation throughout the 1980s and 1990s, particularly with regard to the central bank. These changes have entailed a parallel and gradual strengthening of both anti-inflationary policies and central bank independence. This has resulted in a rupture between current monetary policies from those implemented prior to 1982.

Between the periods of 1925 and 1940, the task of the central bank was to create a financial system that did not exist due to the factionalism that predominated during the post-revolutionary period. As such, monetary stabilisation was subordinated to the goal

of centralising political power and establishing social peace.[14] For this reason, the central bank remained subject to the financing needs of private banks and the state, and therefore had a limited role in economic policymaking.[15]

Between 1940 and 1954, monetary policy concentrated on making available a large pool of credit for private industrialisation. In this process, the role of the central bank was to channel credit to industrialisation through reserve requirements. Reserve requirements were selectively applied to commercial banks according to the different categories of borrowers. At the same time, the government sought to keep wages down through political repression while maintaining favourable conditions for private investment. As John K. Thompson argues: "private industry increased savings in the form of reinvested earnings, as real wages lagged behind profits which rose in response to price increases."[16] Both the corporatist structure of the state and state repression were the mechanisms through which wages were lowered. As such, monetary policy and the central bank had a limited role in affecting wages.

By the end of 1954, price increases and large availability of credit led to inflationary pressures on the Mexican economy. Low wages, in addition to this economic situation, produced great social discontent, which weakened popular support for the PRI. For instance, the CTM voted to stage a general strike on July 12 of 1954 if wages were not increased by 24 percent.[17]

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[14] John K. Thompson, *Inflation, Financial Markets and Economic Development: The Experience of Mexico*, Greenwich: JAI Press, 1979, p. 121.
[15] Jonathan Heath, *Para Entender al Banco de México*, Mexico: Nostar Ediciones, 2006, pp. 11-3.
[16] Thompson, *Inflation, Financial Markets and Economic Development,* p. 69.
[17] Kevin Middlebrook, *The Paradox of Revolution: Labor, the State and Authoritarianism in Mexico*, Baltimore: John Hopkins University Press, 1995, p. 218.

As a result, the economic strategy of the Mexican state changed to restrain inflationary forces *via* controls over money supply, particularly public sector expenditures, during the period of 'stabilising development' (1955-70). While the central bank's role in the economy still relied on the federal government's willingness to follow the bank's recommendations on monetary policy, BANXICO eventually gained prominent roles in policy-making. In this period, price stability became the primary objective of the central bank. The Mexican central bank, therefore, pursued this objective through restraints on government financing.[18]

During the 1970s, the importance of price stability in monetary policy was replaced by increases in state expenditures aimed at fostering the sophistication of the financial system, and, to a lesser extent, subsidising consumption. The only instruments utilised by the Mexican central bank to control inflation were interest rate ceilings and the imposition of multiple reserve requirements on private banks. Attempts to control the money supply in the banking system did not prevent the large availability of credit and financial profits promoted by *financieras*. High interest rates were also employed by BANXICO to encourage peso deposits and 'Mexdollars.'[19] In general, the significance that the central bank gained during the period of 'stabilising development' disappeared during the first half of the 1970s. Monetary policies implemented by the central bank were mainly designed to stabilise the Mexican exchange rate in order to support dollarisation and profits in the Mexican financial system rather than to control inflation

[18] Heath, *Para Entender el Banco de México*, p. 14.

[19] Nora Ampudia Marquez, "Treinta Años de Política monetaria en México. 1970-2000," en Etelberto Ortiz Cruz (ed.), *Hacia Una Política Monetaria y Financiera para el Cambio Estructural y el Crecimiento*, México: Plaza y Valdes, 2003, pp. 126-30.

and prevent the decline of real wages.[20] Increasing profits, credit expansion, and high prices created inflationary pressures on the economy in 1976.

With the devaluation of the Mexican peso from 12.50 pesos to 20.50 pesos per dollar and growing inflation in 1976, the Mexican state tried to calm down the inflammatory situation with the Alliance for the Production (*Alianza para la Producción*), which called for the business sector to invest more and the workers to limit their demands for wage rises.

The state also signed the IMF stabilisation plan, which included austerity measures to balance the public budget, wage freezes and the abolition of price controls. This policy was reversed after Mexican oil reserves increased, and prior economic policies that sustained dollarisation and state spending returned into the state economic agenda.

When the economic crisis unfolded between 1981 and 1982, the central bank became again a central actor in the process of economic decision-making. This can be illustrated with the role of the central bank in defending the Mexican peso after a series of speculative attacks on the currency in the early 1980s. Subsequently, BANXICO withdrew from the foreign exchange market and devalued the currency by100 percent, introduced a dual exchange rate system, increased prices on staples, forced the conversion, and participated in the nationalisation of the private banks.

[20] There was only one attempt to control inflation through the restraint of money supply was in 1974 when the state reduced public expenditures. Thompson, *Inflation, Financial Markets and Economic Development,* p. 206.

Following the debt crisis, price stability became the exclusive policy goal of the Mexican central bank.[21] The use of international reserves and state spending reduction were the primary monetary mechanisms to control inflation.[22] BANXICO also made an active use of interest rates to curtail credit supply and diminish inflation.[23] Thus, the central bank became fundamental in setting interest rates and limiting state financing.

The influence of the central bank over the economy expanded when the crawling peg exchange rate regime was implemented in 1988. The central bank ensured the value of the peso within a band in which the peso could fluctuate relative to the dollar by using international reserves and issuing government debt. In the event that the peso went above the fixed-exchange rate band, BANXICO intervened by buying more pesos in the market, defending the peso, and maintaining established interest rates.[24]

While the central bank gained power in economic management, the main mechanisms to reduce inflation were 'social pacts.' Wage and price restrictions were mainly based on the tripartite *pactos* negotiated by the government with business organisations and PRI unions rather than BANXICO's monetary policy. This remained the most important factor in controlling inflation between 1982 and 1993. Restrictions over money supply were not the main instruments to maintain price stability, but rather the *pactos* and the worthiness of the peso became the most important mechanisms to manipulate price levels by the end of the 1980s and the early 1990s.

[21] Ampudia Marquez, "Treinta Años de Política monetaria en México, 1970-2000," p. 138.
[22] Banco de Mexico, *Informe Anual 1985*, Mexico, 1986, p. 44.
[23] Ampudia Marquez, "Treinta Años de Política monetaria en México, 1970-2000," p. 141.
[24] Banco de Mexico, *Informe Anual 1991*, Mexico, 1992, p. 37.

The Independence of the Mexican Central Bank

Previously, the Mexican central bank was legally subordinate to the Finance Ministry. In 1993, the Mexican central bank gained its independence through a reform in article 28 of the Mexican constitution, which also placed precedence on anti-inflationary policy.

> The state has a central bank that will remain autonomous in the carrying out of its functions. Its high priority objective will be to stabilise the purchasing power of the national currency, while strengthening the direction of the national development which corresponds to the State. No authority can compel the bank to grant financing.[25]

Constitutional reforms also established the new organisational structure of the central bank. The most important authority is the Board of Governors of the Bank of Mexico, which is made up of five members. From among these members, the Mexican President appoints the Governor of the bank, who presides over the Board of Governors. The remaining members are called Deputy Governors and are also appointed by the Executive and confirmed by the Senate. The law of the central bank also mentions that the Governor and Deputy Governors must abstain from participating, as representatives of the bank, in the activities of political parties.[26]

BANXICO's independence helped to institutionalise the policy objectives of price stability and public spending restrictions set in the early 1980s. For instance, reforms to article 28 establishes that the functions of the central bank are to regulate the issuance and circulation of domestic and foreign currency, operate as a reserve bank and lender-of-last-resort for credit institutions, and provide treasury services to the federal government.

[25] Constitución Política de los Estados Unidos Mexicanos, article XXVIII, § 6.
[26] Ibid., article XXVIII, § 7.

Also, the central bank's law specifies a limit on the financing of federal government, which must never exceed the equivalent of 1.5 percent of the Federal Government's expenses. If a negative balance exceeds this limit, BANXICO can proceed to place securities payable by the federal government on the market, on behalf of the government for an amount equivalent to the balance in excess of the limit.[27] As a whole, the autonomy of the Mexican central bank was intended to protect the bank from political pressures that had the potential of expanding credit, increasing public spending for electoral purposes, and generating a fiscal deficit and inflation.[28]

After the 1994 peso crisis and the return to a floating exchange rate regime, the central bank devised a new strategy that would allow BANXICO to control inflation while maintaining the value of the peso. This new strategy consisted in the *corto* or 'short.' The implementation *corto* shows that the central bank's capacity to formulate anti-inflationary policies separate from the state financing needs has expanded as its independence consolidates.

The 'short' was the mechanism that the Mexican central bank used to tighten the monetary conditions of the economy in accordance with inflation targets. This policy instrument was designed to restore so-called 'orderly' conditions in money and capital markets. The central bank squeezed the money supply by leaving banking system reserves short (or *corto*) and restricts liquidity in the system.[29]

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[27] Ley del Banco de México. art. XXII, § 4.
[28] Presidencia de la Republica, *Exposición de motivos de la iniciativa de Decreto por el que se Reforman los artículos 28, 73 Y 123 de la Constitución Política de los Estados Unidos Mexicanos, Enviada al H. Congreso de la Unión por el Ejecutivo Federal,* Mexico, 1993.
[29] John Authers, "Beyond Borders: The Price of Passion," *Financial Times*, 9 November 2004.

As BANXICO did not provide the banking system with sufficient resources at market interest rates, banks needed to draw on their required reserves through overdrafts on their current account with BANXICO. This produced an increase in interest rates.[30] Also, the Mexican central bank implemented a process to sell its foreign reserves through the issuing of public debt in order to keep the circulation of money 'short.' As a result, the central bank was, to some degree, able to influence domestic interest rates, according to movements in the U.S. Federal Reserve's rates in treasury bills and increases in Mexican prices, in order to keep liquidity in the secondary market below demand, push up interest rates, and dampen spending.

In practice, the *corto* was used to reverse declining interest rates so as to maintain the value of the peso and control inflation. On May 1996, the central bank increased the *corto* in response to a rise in interest rates of U.S. 30-year public bonds. According to the Mexican central bank, the latter was causing a depreciation of the peso.[31] By 2002, the central bank increased the *corto* from 400 million pesos to 475 million pesos. In 2003, BANXICO increased this amount to 550 million pesos. The amount of the *corto* decreased in 2004 in relation to 2003. In 2005, the amount of the 'short was 79 million pesos.[32] The *corto* represents the beginning of the consolidation of inflation targets as the main objective of Mexican monetary policy (See Figure 10).[33]

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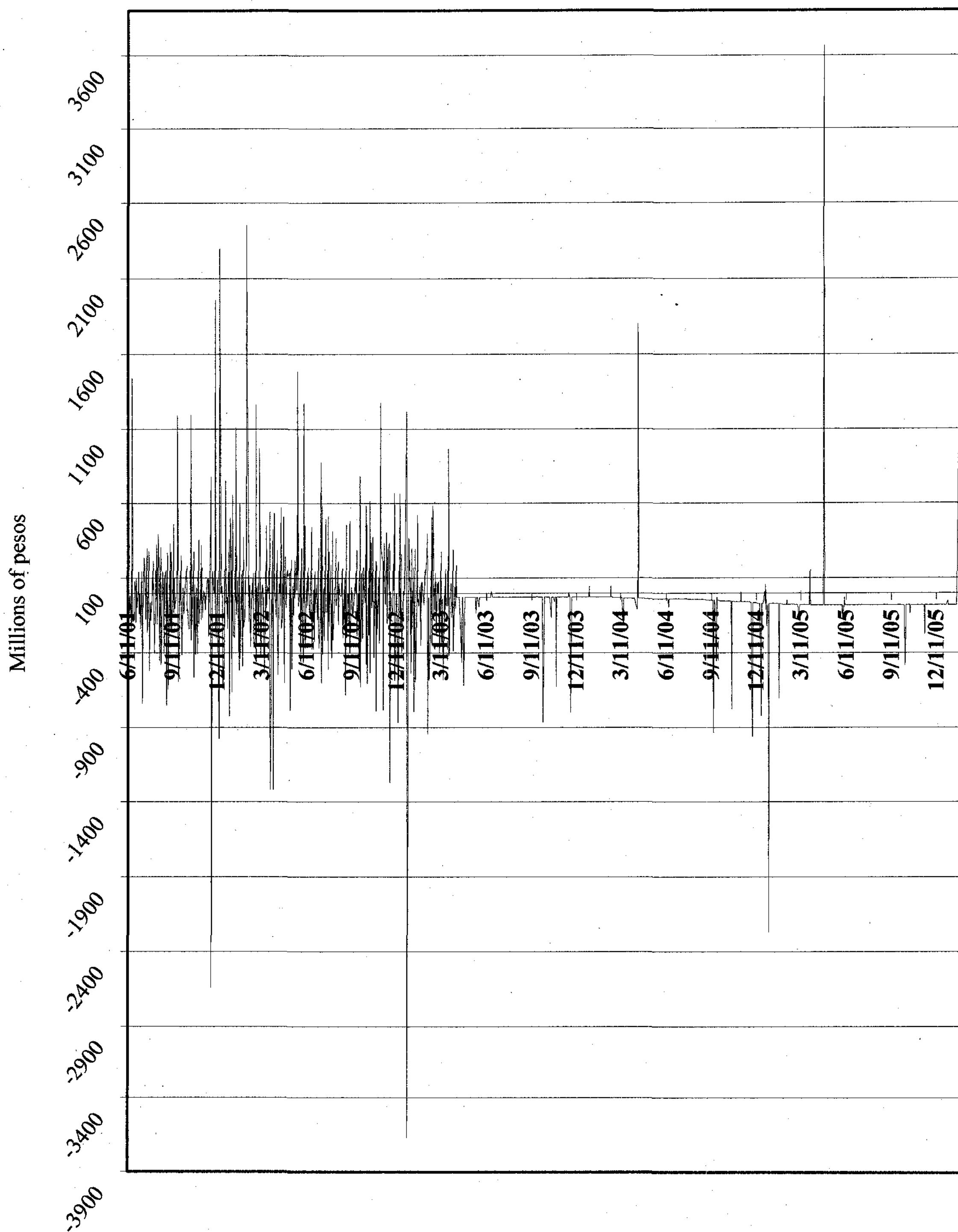
[30] This is a portion of credit that the central bank supplies each day at double prevailing interest rates.
[31] Banco de México, *Política Monetaria. Informe sobre el Primer Semestre 1996*, Mexico, September 1996, p. 46.
[32] Fortunato Cuamatzin Bonilla, "El Corto Monetario, ¿Cansancio o Agotamiento?," *La Jornada de Oriente*, 11 May 2005.
[33] The Mexican central bank announced the end of the *corto* as a monetary policy on November, 2007. Anonymous, "Anuncia Banxico 'Muerte oficial' del Corto," *Milenio*, 4 November 2007.

Figure 10. BANXICO's Intervention through the *Corto*



Source: Banco de Mexico, *Intervención en el Mercado de Dinero*, Mexico, 2006.

As the Mexican inflation rate has remained low and stable, the Mexican central bank has moved towards a policy of inflation targeting. Beginning in 1999, a fully fledged inflation target became the focal point of monetary policy. In order to adjust the existing inflation rate to the inflation target, the Mexican central bank has raised or decreased the interbank overnight rate (*tasa de fondeo bancario).*[34] When inflation has increased beyond the inflation target, the central bank has raised the interbank overnight rate (See Figure 11).[35] The present target of a rate of inflation is three percent with a band of one percentage point, and it has only been achieved in the last seven years[36] (See Figure 12).

According to the Governor of the Mexican central bank, the benefits of this framework include a considerable reduction of real and nominal interest rates. Ortiz has also stated that this new approach to central banking fosters the deepening of the financial system .[37] In general, the *corto* and inflation targeting have changed monetary policy in two ways.

First, the exchange rate is no longer as explicit an objective along with inflation controls as it was back in 1994. The goal of monetary policy now is to achieve a low, stable, and predictable rate of inflation. Second, decisions are now guided by the inflation target set by the central bank independently from other economic variables such as employment and economic growth.

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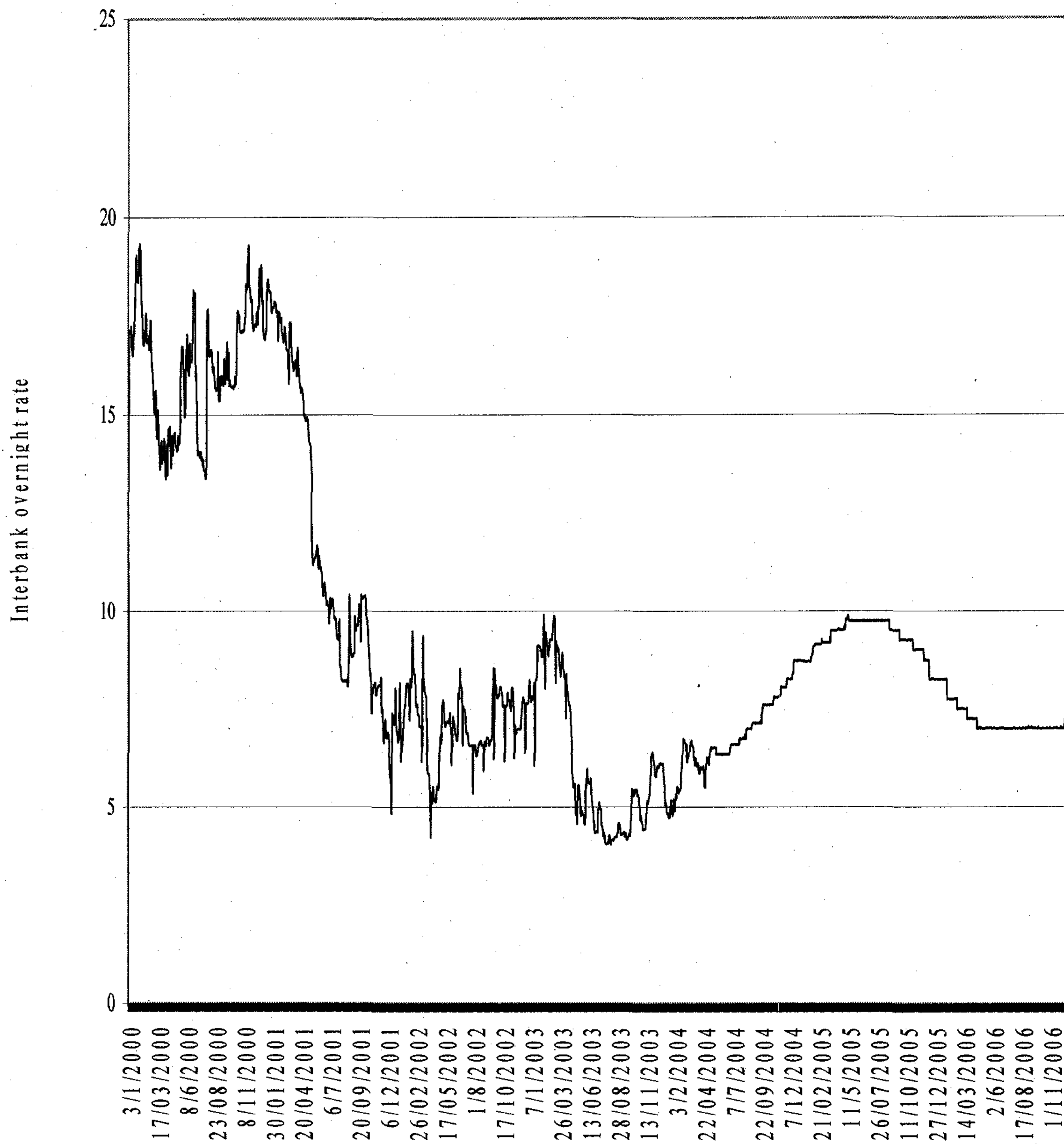
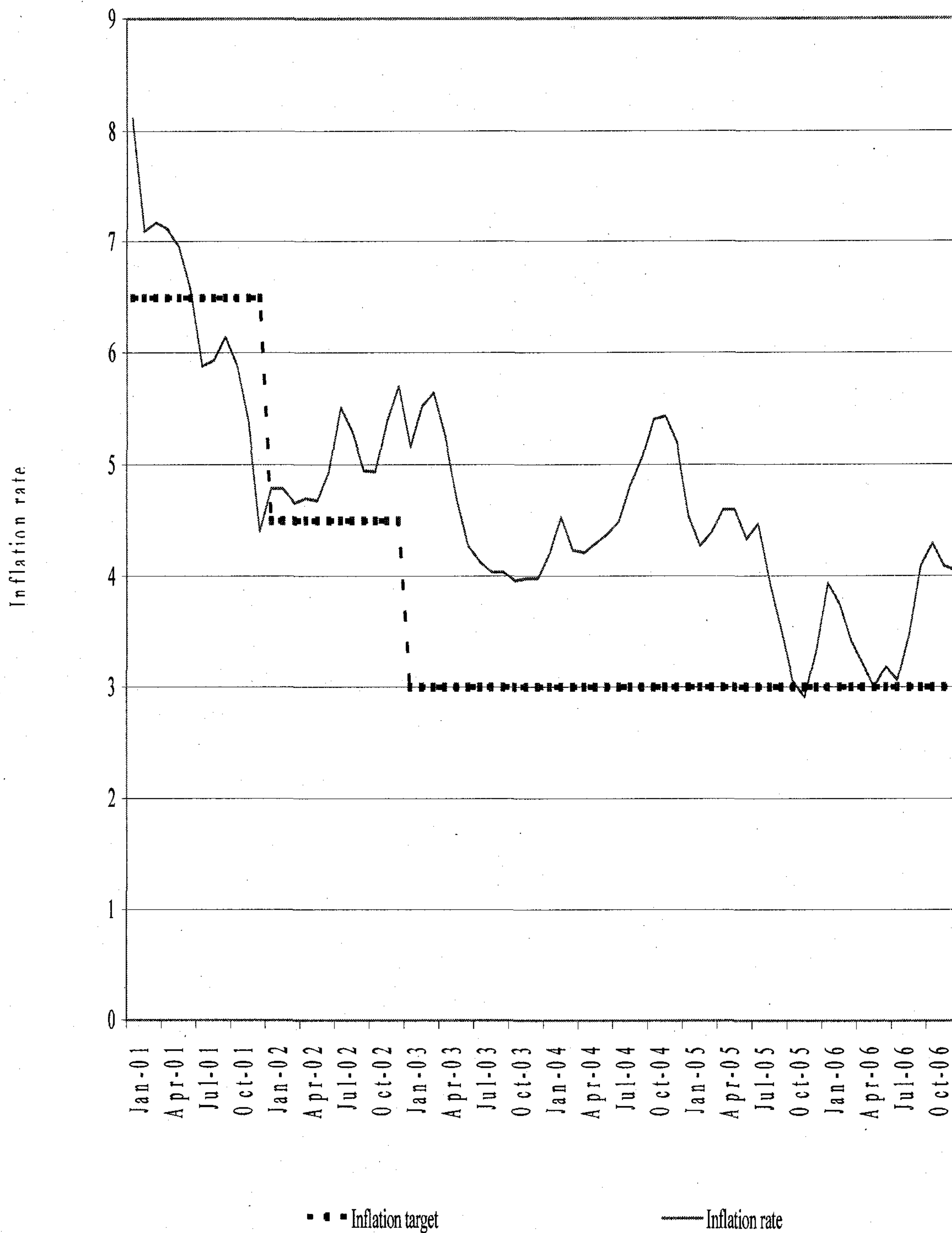
[34] The interbank overnight rate is the interest rate which banks pay or charge to borrow funds from or lend funds to other banks on an overnight unsecured basis.
[35] Anonymous, "Eleva Banxico tasa de interés vs la carestía," *El Porvenir*, 28 April 2007.
[36] Heath, Para Entender al Banco de Mexico, pp. 46-9.
[37] Banco de México, *Palabras del Dr. Guillermo Ortiz, Gobernador del Banco de México, en Ocasión de la Sexagésima Novena Convención Bancaria*, Acapulco, 24 March 2006.

Figure 11. Interbank Overnight Rate



Source: Banco de Mexico, *Tasas de Fondeo Bancario*, Mexico, 2007.

Figure 12. Inflation Target and Rate



Source: Banco de Mexico, Informe *de la Inflación 2001-2006*, Mexico, 2006.

Inflation and Labour in Mexico's Monetary Policy

Inflationary pressures have been a constant variable of the Mexico's contemporary economic history. Despite the damaging effects of inflation on workers' purchasing power, price stability was not always the most import objective of economic policy between 1925 and 1982. The only exception was the period of 'stabilising development.' Monetary mechanisms to control inflation repeatedly targeted the quantity of money, particularly through state spending reductions. Policies that focused on lowering wages to control inflation and increase private firms' profits usually fell outside the realm of monetary policy. These policies were particularly negotiated and implemented through the corporatist structure of the state.

The debt crisis, however, placed low inflation at the centre of the economic agenda. This was often achieved through the setting of high interest rates, cuts in government spending, and exchange rate policy. Still, control over wage demands remained negotiated through the PRI. After the peso crisis, the central bank's monetary policy of low inflation has been based on lowering wages, increasing productivity, and setting stable yet profitable interest rates through the *corto* and inflation targets.

The *corto* made capital investment issued in pesos more attractive and guaranteed high returns on peso investment by increasing interest rates, signalling to financial investors their commitment to economic stabilisation with attractive interest rates and a stable currency. The shift toward an inflation target has further reinforced the central bank's commitment to price stability. More specifically, inflation targeting indicates to

investors that the central bank will employ all instruments available to lower inflation, maintain interest rates at profitable levels, and guarantee the worthiness of the peso.

Both the *corto* and inflation targeting have created a policy dilemma in the Mexican state's mediating role in the process of capital accumulation. On the one hand, the 'short' and inflation targeting maintain interest rates at stable yet profitable rates. This is favourable to capital that reproduces internationally and invests in financial markets. High interest rates and a strong currency, however, also bring about profit constraints to the export-oriented sector. This sector is then affected by high interest rates due to limitations to borrow domestically. High exchange rates diminish competitiveness of exports in international markets and increase the costs of imported-inputs for production. At the same time, large exporting firms have increasingly become financially oriented, and hence, these companies also have invested interests in a strong peso and profitable interest rates. This dilemma between competitiveness and profitable interest rates has been illustrated by the Governor of the Mexican central bank, Guillermo Ortiz, who argues that:

> During the first half of this year, aggregate demand and GDP have been growing at annual rates above 10 and seven percent, respectively. Due to the threat that this growth represents to long-term inflation targets, the Bank of Mexico has been on a tightening mode throughout the year. This has led to high real interest rates and contributed to the appreciation of the currency... The appreciation of the currency generated a doubling of the non-oil trade balance deficit between the first half of 2000 and the same period of 1999.[38]

[38] Guillermo Ortiz, "How Should Monetary Policymakers React to the New Challenges of Global Economic Integration," *Symposium Proceeding Kansas Federal Reserves: Global Economic Integration: Opportunities and Challenges*, Kansas, 2000, p. 269.

The Mexican state had attempted to mediate these contradictions by focusing on labour as the main target to reduce inflation. According to the Mexican central bank, under an inflation targeting framework, monetary policy must be tightened when inflationary pressures come from the demand side. When inflationary pressures originate from the supply side, the central bank does not need to tighten monetary policy since these pressures are "only a reflection of changes in relative prices." [39]

This indicates that the Mexican central bank tightens monetary policy when wages increase and does not intervene in the economy when prices soar. In this way, large exporting companies can maintain low competitive prices by reducing labour costs despite a strong peso. At the same time, stable interest rates can be guaranteed for financial investors.

According to the central bank, inflation has been caused by high wages.[40] BANXICO has pointed out that "monetary policy needs to limit the expansion of aggregate demand with the purpose of reducing inflationary pressures caused by excessive increases of domestic spending."[41] BANXICO has also defined inflation as the result of workers 'living beyond their means.'

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[39] Banco de México, *Informe sobre la Inflación 2004 y Programa monetario 2005*, Mexico, 2005, p. 23.
[40] Banco de México, *Política Monetaria. Informe sobre el Primer Semestre 1995*, Mexico, September 1995, p. 34; Banco de México, *Política Monetaria. Informe sobre el Primer Semestre 1996*, Mexico, September, 1996, p. 46; Banco de México, *Política Monetaria. Informe sobre el Primer Semestre 2001*, Mexico, September, 2001, p. 5, Banco de México, *Política Monetaria. Informe sobre el Primer Semestre 2002*, Mexico, September, 2002, p. 3. Here the Mexican central bank also indicates that other factors that affect inflation are the fall in oil prices and instability in international capital markets
[41] Banco de México, *Política Monetaria. Informe sobre el Primer Semestre 2002*, p. 7.

For instance, the central bank has indicated that "the slow decrease of inflation is due to wage increases superior to actual productivity of workers."[42] This, accordingly, increases the amount of circulating money and, consequently, prices in the Mexican economy. As such, the economic rationalist notion that considers low wages as a mechanism to manipulate price expectations predominates within Mexican monetary policy.[43]

It is assumed that the high interest rates produced by the 'short' and inflation targeting creates incentives for saving and diminishes unnecessary borrowing. These assumptions are, however, problematic, since they consider full employment and the state as the only supplier of pesos. In other words, inflation needs to be reduced, not by cutting capital's demands on profitable interest rates and high prices, but by curtailing labour's demand.[44] This makes price stability, the main objective of monetary policy, a political strategy to solve class contradictions among capitalists and undermine labour.

In fact, inflation targeting has intensified even more the role of workers' wages as the main mechanism of national adjustment to global accumulation. While the *corto* also targeted aggregate demand in the form of low wages, the 'short' was also a more flexible mechanism. Lorenza Martínez, Oscar Sánchez, Alejandro Werner argue that:

> [T]he instrument only works as a signal that interacts with the action taken by market agents. Under volatile conditions, the preceding argument implies that the short-term interest rate changes automatically, making it very flexible and

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[42] Banco de México, *Política Monetaria. Informe sobre el Primer Semestre 2001*, p. 5.
[43] This reflects the economic rationalist notion of inflation which assumes that the central bank can reduce future inflation rates by raising real interest rates, thereby slowing down economic growth. If the central bank credibly commits to reducing inflation, then price setters – that is firms and workers – will lower inflation expectations into their pricing behaviors.
[44] Dick Bryan, *The Chase Across the Globe,* pp. 76-7.

> allowing the distribution of external shocks between changes in it and in the exchange rate.[45]

In contrast, "the implementation of monetary policy based on an objective for the short-term interest rate represents a much more direct signal."[46] If the Mexican central bank raises the overnight interest rate, investors are attracted to the higher yields on the Mexican peso. This capital inflow increases the demand for pesos and causes it to appreciate in foreign-exchange markets. Also, increases in interest rates might lower the demand for goods and an appreciated peso might reduce the growth of income of Mexican exporters. The reduction in the growth of investment and consumption spending, combined with the reduction in the growth of net exports, implies a reduction in the aggregate demand. The reduction in the growth of aggregate demand caused by BANXICO's raising interest rates causes a slowing GDP growth. The fall of the level of the GDP means that Mexican firms are producing below their capacity, which is eventually felt in the markets for labour and leads to reductions in wages. The lowering of the costs of labour then contributes to a reduction in the rate of inflation.[47]

The direct effects of the implementation of inflation targeting on the working classes can be illustrated with the increase of corn prices in January 2007. In the early days of January 2007, corn tortilla prices in Mexico increased more than 50 per cent, pushing inflation up to 4.21 percent beyond the inflation target of three percent.[48] Price increases in corn led to a deterioration of the purchasing power of low-income families in

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[45] Lorenza Martínez, Oscar Sánchez, Alejandro Werner, "Monetary Policy and the Transmission Mechanism in Mexico," *Bank of International Settlement Papers*, 8, 2000, p. 186.
[46] Ibid.
[47] Ibid., p. 188.
[48] Banco de Mexico, *Informe sobre la Inflacion Enero-Marzo 2007*, Mexico, 2007, p. 3.

Mexico. While a person earning the minimum wage spent from 10 to 14 per cent of her daily salary on corn tortillas in 2006, this same person had to spend about 30 per cent of her wage on this same product in 2007. While inflation increased, wage increases lagged behind inflation.

The central bank reacted to these inflationary pressures by tightening monetary policy even more three months later.[49] BANXICO raised interest rates from seven to 7.25 percent, increasing yields in peso investments in financial markets in order to stop inflationary pressures and reach the inflation target of three percent by the end of 2007.[50] Wage levels, in contrast, remained below both interest rates and price increases.[51] When corn prices escalated, the government rejected any policy shift towards the relaxation of the inflation target, the implementation of price controls, subsidies, and wage increases.

The Governor of BANXICO has argued that wage increases would only intensify inflation.[52] The divergence between stagnant wages and escalating corn prices, rising inflation, and interest shows how labour is the link between interest rates and the rate of inflation in the context of inflation targeting and global financial markets. Workers' wages are the transmission mechanism of global discipline to the national economy *via* the Mexican central bank. In other words, wages have to adjust to inflation targets in order to comply with the price and currency stability required by global financial markets. The rationale behind inflation targeting is that economic agents – firms and

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[49] Another government response to increases in corn prices was an agreement with the private sector. Producers and distributors of corn and tortilla have consented to settle the price of tortilla. In return, the Mexican government has agreed to guarantee the supply of corn by extending the quota of American corn.
[50] Banco de Mexico, *Informe sobre la Inflación,* p. 41.
[51] Wages only increased 4 percent. Ibid., p. 26.
[52] Anonymous, "Burbuja Inflacionaria hasta Junio: Banxico," *El Economista,* 29 January 2007.

workers – will believe in the target set by the central bank and make their pricing decisions based on this. While this might be the case for financial firms, it is not for workers. Pressures on workers to prevent lower wages and increase productivity occur through policies that combine 'progressive competitiveness' and 'punitive austerity.'

Punitive austerity can be defined as the tightening of government spending, further privatisation of public functions, and the reduction of wages *via* high interest rates and the weakening of labour unions.[53] This is shown in the radical deterioration of wages, (See Figure 13).[54] By setting the inflation target, the central bank has the institutional means to bring about a reduction in budget deficits. Since the central bank cannot provide financing to the government beyond certain limit, the Mexican state has reduced its social spending and has increased its reliance on public debt (See Figure 14). The Mexican state has also integrated policies of 'shaped advantages,' to increase labour productivity through the training of workers, technological innovation, research, and workplace trust.[55] This strategy of 'progressive competitiveness' has been carried through the strategy of the *nueva cultural laboral* or 'new labour culture,' which refers to the shift from reliance on the PRI's corporatist unions to the acquisition of skill and training.[56]

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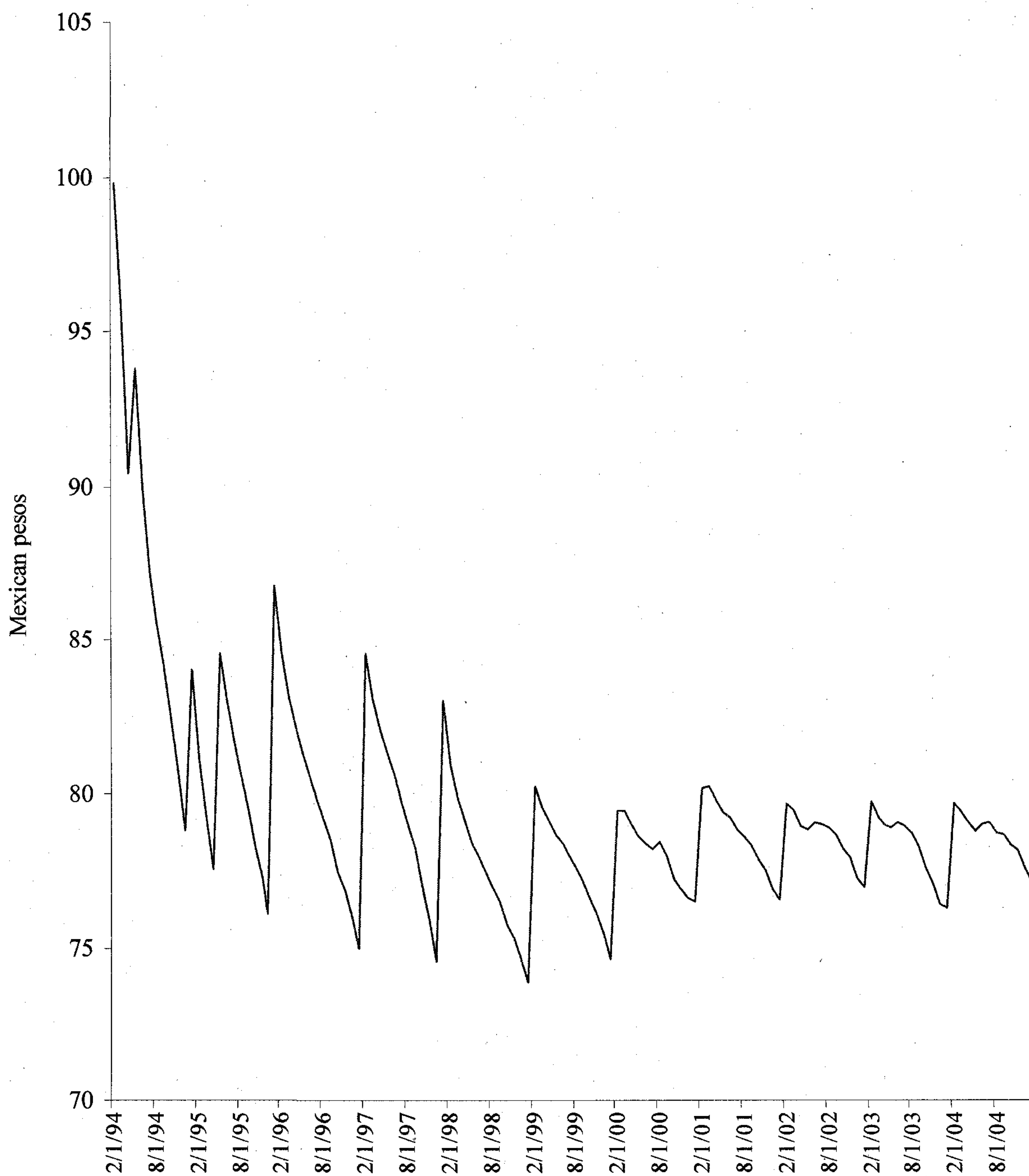
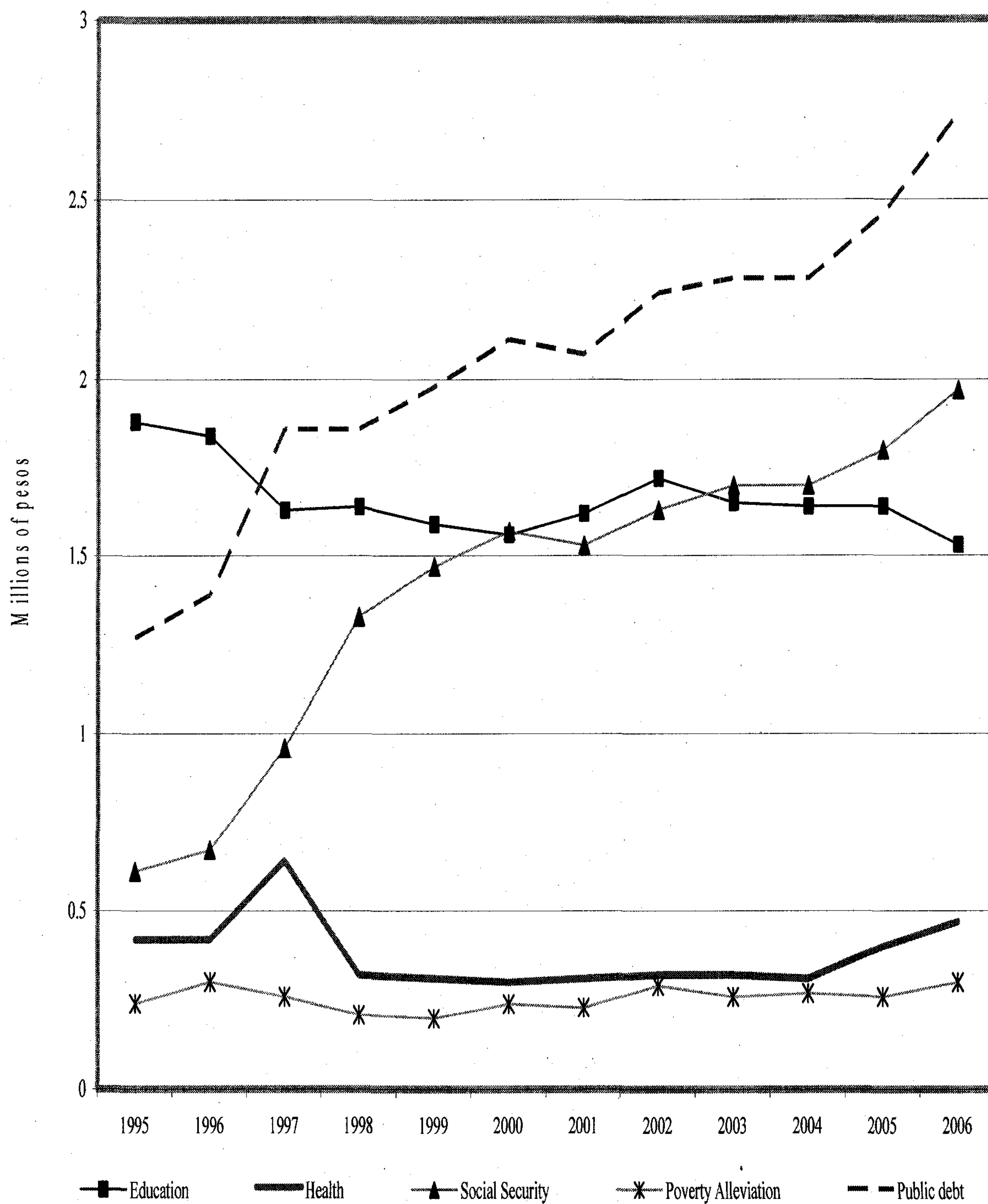
[53] See: Greg Albo and Dan Crow, "New Bargaining Strategies? USWA and the New Economy," *MRzine*, 19 September 2005.
[54] According to the National Institute of Statistics and Geography's (INEGI), approximately 30 million of Mexicans survive with less than 30.5 pesos a day in 2004. Close to 10 million Mexicans live on 12.21 pesos a day - that is 1.1 US dollars. Thus, a large percentage of the Mexican population does not even earn a minimum wage. Victor Cardoso and Juan Zúñiga, "Más de 30 millones de Mexicanos con Menos de un Salario Mínimo," *La Jornada*, 16 June 2005.
[55] Greg Albo, "A World Market of Opportunities? Capitalist Obstacles and Left Economic Policy," in Leo Panitch and Colin Leys (eds.), *Socialist Register 1997: Ruthless Criticism of all that Exists*, London: Merlin Press, 1996, p.16.
[56] Presidencia de la República, *Fox Contigo*, Mexico, 19 April 2004.

Figure 13. Minimum wages, 1994-2005 (prices in pesos of 1994)



Source: Banco de Mexico, *Indicadores Economicos y Financieros. Salarios mínimos*, Mexico, 2006.

Figure 14. Allocation of Government Budget Expenditures (millions of pesos)



Source: Centros de Estudios de las Finanzas Públicas, *Evolución del Gasto Público*, Mexico, 2007.

According to the Mexican Ministry of the Economy, this new policy has allowed more than a million workers to be trained and has resulted in increased productivity and better salaries.[57] The suggested strategy of promoting skills and expertise among the workers to increase competitiveness is problematic and self-defeating. Such a strategy encourages investment in high-tech and export-oriented sectors. It also promotes what is referred to as highly skilled and flexible labour to improve employment and wages. This, the proponents argue, is necessary to maintain a current account surplus that offsets the negative effects of the capital account.[58]

Advocates of this strategy, however, ignore that capital can adapt leading technologies in low wage economies such as Mexico, pushing wages downwards and further deteriorating the living standards of workers.[59] With respect to finance, Greg Albo notes that the mobility of capital in financial markets is an obstacle for the strategy of 'shaped advantages' – improvement of workers' skills and institutional state capacity to regulate finance – because the latter requires a long-term time-horizon. Investors become more reluctant to be tied to long-term, country specific ventures, while the options of short-term portfolio investments carrying less risk and more profit increase.[60] Indeed, strategies of 'progressive competitiveness' and 'punitive austerity' are mechanisms that complement BANXICO's inflation targeting.

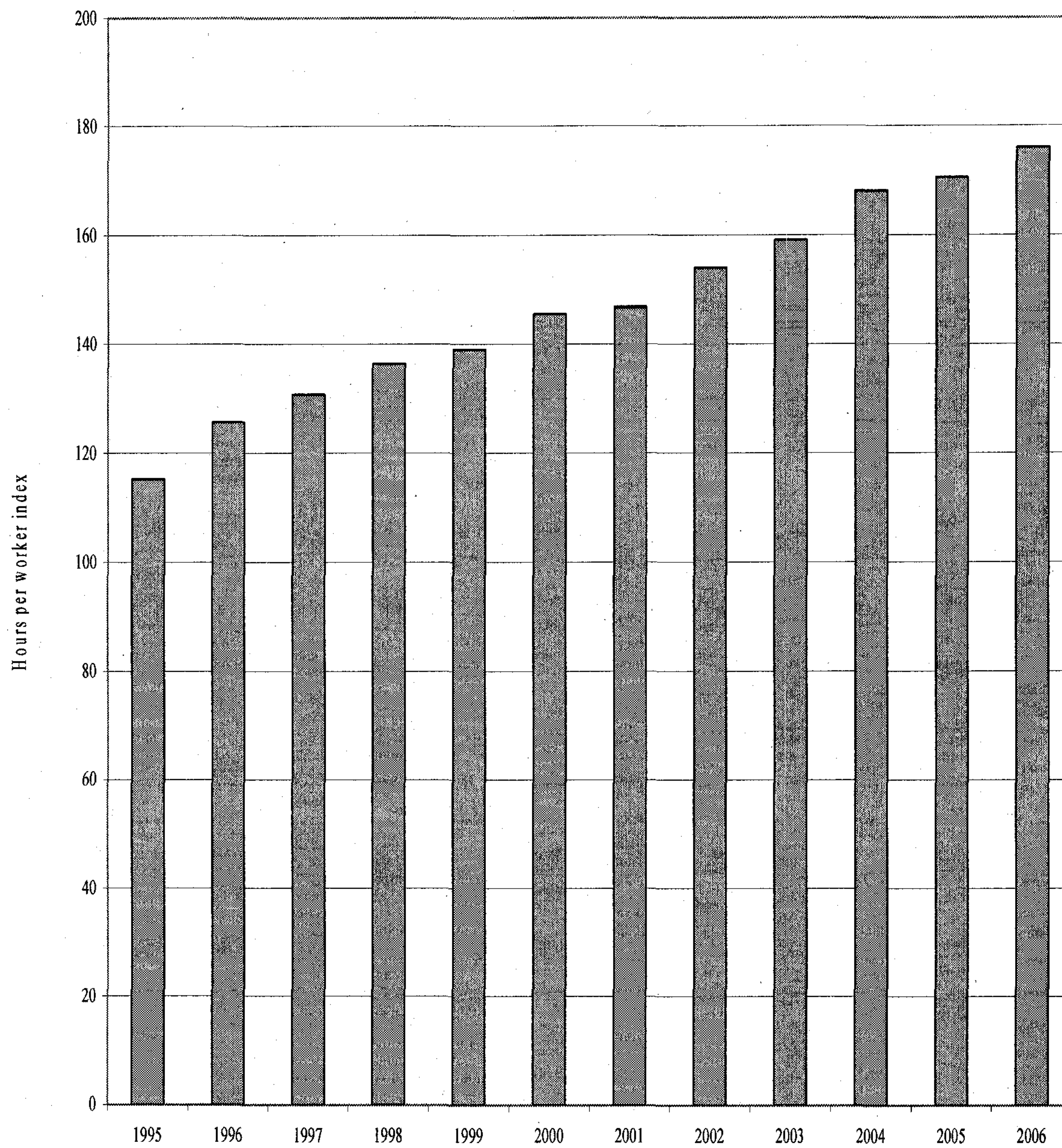
[57] "Crea Fox Instituto de Protecciôn Social," *La Crónica*, 1 May 2005.
[58] Some of these negative effects are the increase in imports and the overvaluation of the currency, preventing the growth of the export-oriented sector and hence diminishing job opportunities in these industries.
[59] David Coates, *Models of Capitalism*, Cambridge: Polity Press, 2000, p. 254.
[60] Albo, "A World Market of Opportunities?" p. 24.

These strategies seem consistent with the economic rationalist emphasis of the Mexican central bank to adjust wages in accordance with productivity in order to prevent inflation. This was expressed by the Governor of the Central Bank and the Minister of Finance in the Letter of Intent of 1999 to the IMF: "The trend toward decentralised negotiated private sector wage increases tied to productivity gains should help to ensure Mexico's competitive edge."[61] Wages, in fact, have remained stagnant despite increases in Mexican workers' productivity (See Figure 15). Labour productivity has increased 54.6 percent between 1988 and 2000.[62] This confirms that labour has become the target of monetary policy in order to increase labour productivity while securing profits and price stability. By targeting labour, the Mexican state mediates class conflict and the contradiction between the international nature of accumulation and the national character of state regulation. On the one hand, national competitiveness, through the shrinking of workers' wages and increasing productivity, allows the export sector to secure profits despite high interest rates and an appreciated peso. On the other hand, national competitiveness combined with the *corto* and inflation targeting guarantees the means for the realisation and reproduction of financial capital and financially oriented exporting firms. Indeed, the anti-inflationary policies of the 'short' and inflation targeting have led to declining inflation rates in Mexico. Still, these policies have not promoted economic growth (See Figure 16).

[61] International Monetary Fund, *Mexico Letter of Intent and Memorandum of Economic Policies 1999,* Washington D.C, 15 of June 1999.

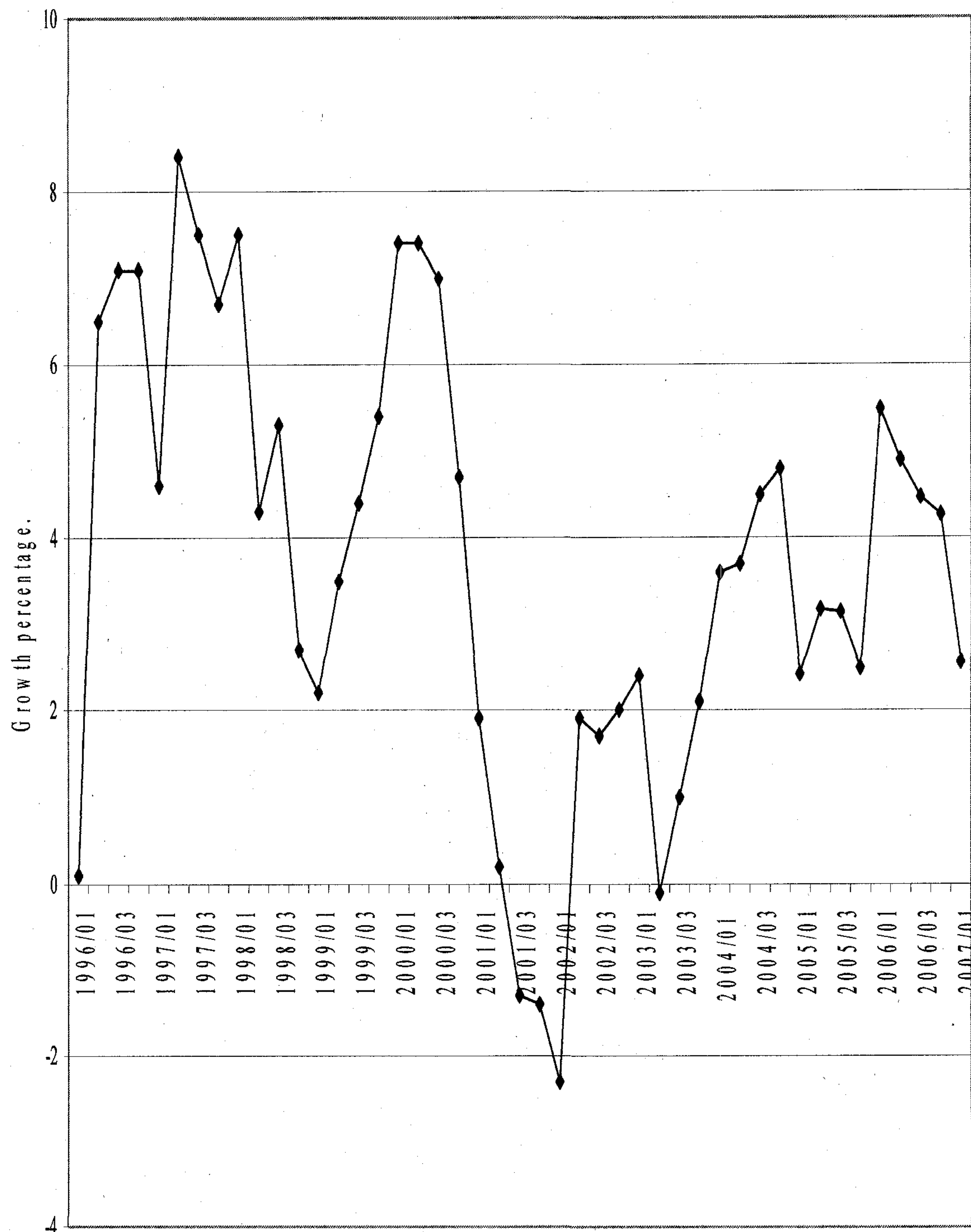
[62] Miguel Angel Barrios y Abelardo Mariña Flores, "Empleo, Industria y Productividad en la Industria Manufacturera Mexicana, 1988-2002," en Ana Alicia Solís de Alba, et al. (eds.), *Globalización, Reforma Neoliberal del Estado y Movimientos Sociales,* Mexico: Itaca, 2003.

Figure 15. Labour Productivity in the Mexican Manufacturing Sector (hours per worker index)



Source: INEGI, *Encuesta Industrial Mensual*, Mexico, 2006.

Figure 16. Mexico's GDP (annual percentage)



Source: INEGI, *Sistema de Cuentas Nacionales de México*, Mexico, 2006.

Furthermore, the Mexican state hides and reproduces the power relations that interplay in the reproduction of capital through financial markets, public debt, and their influence in setting prices by holding workers responsible for inflation These anti-inflationary policies disguise the processes through which financial instruments and markets create inflation. Rising interest of public bonds can be a form of inflation that adds more money to the financial system.[63]

As such, state debt and state support to bank liquidity can create extra money in the economy, leading to further inflation. Prices are also being driven by financial markets, since a good or service might be exchanged once or twice, but these same goods and services might change hands several times in a derivative operation.[64] Thus, the increase in prices is not necessarily driven by labour demands on wages, but rather by operations in capital markets.[65] This is concealed by policies that hold workers' wages and consumption responsible for high inflation and use inflation as a political strategy to redistribute wealth. While those social agents that can access and control capital markets

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[63] David Folkerts Landau, "Potential to External Financial Markets to Create Money, Credit and Inflation," *IMF Staff Papers*, 29, 1982, p. 101. As Dick Bryan also points out, a derivative operation might only involve the payment of a small amount of money or collateral, but it has assets worth a lot of money. "[Someone] will pay a dollar to buy an option to buy (or sell) shares (at a certain price at a certain time) that may themselves trade for 30 dollars." Also, prices are being driven by speculative markets since a good or service might be exchanged once or twice, but these same goods and services might change hands several times in a derivative operation. Dick Bryan, "The Pass the Rick Trick," *Workers Online,* 75, 2000. This is confirmed by the Mexican case in the sense that the Price Consumer Index rate (Indice de Precios de la Canasta Básica, or IPCB) has reflected a gradual decrease in prices during 2005. Yet, inflation rates are still rising and BANXICO still blames salaries and the prices of agricultural products despite declining food prices and low wages. Carlos Fernández Vega, "Las Recetas No funcionales del Banco de México," *La Jornada*, 10 May 2005.

[64] Dick Bryan, "The Pass the Rick Trick," *Workers Online,* 75, 2000.

[65] Alfredo Saad-Filho and Maria de Lourdes R. Mollo, "Inflation, Currency Fragmentation and Stabilisation in Brazil," *Research Papers in International Papers, South Bank University London*, 17, 1999, pp. 5, 21.

get wealthier, labour loses strength as their wages and their living conditions are worsened by anti-inflationary measures.

From Political to Technocratic Authoritarianism: The Independence of BANXICO

The succession of financial crisis and government deficits raise important questions regarding the process of economic decision-making in Mexico. More specifically, how has the Mexican state, particularly the Executive branch, been able to carry out monetary policies that cause great social discontent? This seems particularly puzzling after the breakdown of the PRI's monopoly over the state, the liberalisation of the electoral process, and the pledges of the Action National Party (Partido Acción Nacional, or PAN) to transparency and social justice. It is also necessary to address why the Mexican state did not grant independence to the central bank until the 1990s.[66] Indeed, the 1990s was characterised by the transformation of central banks into independent institutions throughout Latin America.[67] Still, it would be misleading to interpret the independence of the Mexican central bank as the result of external pressures and tendencies. Rather, it remains central to understand the historical and social conditions that led to the independence of the Mexican central bank.

It is helpful to begin by looking at the highly politicised character of economic decision-making during the 1980s and early 1990s. This can be seen in the union strikes in public universities and public and private companies that followed the 1982 debt

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[66] It is worth noting that the PAN introduced the initiative of the bank's autonomy into the Congress since 1948. Yet, this measure was implemented 45 years later. Juan José Hinojosa, "Redescubrimiento del Banco de Mexico," *Proceso*, 5 May 1993.

[67] See: Carstens and Jácome, "La Reforma de los Bancos Centrales Latinoamericanos."

crisis.[68] Unions protested as a response to De la Madrid's monetary policies of wage ceilings to control inflation. Social discontent was also reflected in the 1988 presidential elections when the main electoral challenge to the PRI came from the presidential candidate from the PRD Cuauhtémoc Cárdenas. This signaled the rise of a political opposition in Mexico at the national level. In this same year, the PRI lost two thirds of its seats in the Chamber of Deputies. Even the leader of the PRI's CTM Fidel Velázquez, who usually supported state policies, criticised these anti-inflationary policies and pressured the government to increase workers' salaries.[69]

While the social 'pacts' of the 1980s and early 1990s were relatively successful measures in containing class struggle after the debt crisis and avoiding criticism of the state's monetary policies, this reliance on the corporatist structure of the PRI was a weak political strategy to circumvent political pressures on monetary policy. The PRI still relied on the official unions to maintain the party's strength and issues of money management could still be debated and revised by different political forces *via* the organisational structure of the official party.

Even though Salinas' administration attempted to dismantle the PRI's traditional structure through PRONASOL in the late 1980s and early 1990s, disagreement among political actors over monetary policies, particularly between union leaders and the Executive, continued to threaten politically the state's economic strategy. The CTM, for

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[68] Samuel Mayer Puente, "Situam: Huelga Lícita," *Proceso*, 19 February, 1983; Gerardo de la Garza, "La Huelga Exhibe que la autonomía es un mito," *Proceso*, 25 June, 1983; Salvador Corro, María Ibarra, Antonio Zúñiga, "Dos semanas de movilización popular," *Proceso*, 11 June 1983.
[69] Salvador Corro, "Fidel Presiona y se Define. Pero el Salario de Emergencia se Hace Humo," *Proceso*, 21 May 1983.

example, rejected the government's celebration of single digit inflation in 1993.[70] As such, anti-inflationary measures were heavily reliant on *ad hoc* political mechanisms within the PRI, and social disagreement exerted influence on the outcomes of economic policy. This, in turn, jeopardised the permanence of policies targeting wages and social spending. For that reason, anti-inflationary policies had to be institutionalised through the autonomy of the central bank and its 'neutral' anti-inflationary policy target to solve concerns of limiting the Mexican state government spending and preserve low inflation.

The official Mexican explanation for the adoption of central bank autonomy is based on the assumption that a persistent inflationary bias has been built into the monetary policy preferences of politicians, particularly during the PRI period in power during the 1970s.[71] In other words, policy-makers had strong political incentives to carry out lax control of the money supply to increase government spending, increase wages, thereby enlarging domestic consumption to underpin electoral strength. Monetary policies, in other words, helped to maintain the hegemony of the PRI's 'populist sector.'[72] The Mexican official explanation to the independence of BANXICO also considered that inflationary bias in monetary policy could only be remedied by giving authority to government officials that choose non-inflationary policies. This strategy of depolitisation of public economic management – that is, the removal of politics from monetary policy implemented through the bank's autonomy – portends to be rational and scientific and

[70] Carlos Acosta Córdoba, "Triunfalismo presidencial; Escepticismo obrero," *Proceso*, 10 July 1993.
[71] Banco de Mexico, *Informe Anual 1993*. Mexico, 1994, pp. 232-4.
[72] See Robert Grosse, "Private Sector Solutions to Latin American Debt Policy failure, Moral Hazard and Market Solutions," *Cato Policy Analysis*, 243, 1992.

suggests that policy-making should rely on rules such as low inflation rather than on views based on public participation.

Despite the legal recognition of the Mexican central bank as an independent institution from the Executive in 1993, *de facto* independence of BANXICO did not take place immediately. The monetary policy of a crawling peg of the peso and the vested interests of the power bloc in this exchange rate regime prevented the Bank of Mexico from creating policies apart from the needs of state financing. More specifically, the Mexican power bloc, particularly dominated by financial groups, relied on an appreciated peso. After the privatisation of the banking system carried out by the Salinas Administration, the 'new' bank owners obtained high profits from borrowing in dollars, investing in public debt in pesos, and from gains in risky positions in the derivatives markets. The profitability of these operations, including the state capacity to pay public debt, depended on BANXICO's ability to intervene in money markets and raise interest rates to defend the peso.[73] This can be seen in the expansion of the monetary base during 1994. Whereas the monetary base grew at an average nominal rate of 7.3 percent in 1993, the monetary base rose to 20.6 percent the following year. During the same year, interest rates rose from 10 percent to 18 percent until December 1994.[74] As such, the policies of BANXICO were not set independently even after the constitutional reforms of 1993. This was reflected in the design of the Law of the Bank of Mexico, particularly Article 23. This article establishes that the central bank governor could be removed for

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[73] Francisco Gíl Díaz and Agustín Carstens, "Pride and Prejudice: The Economics Profession and Mexico's Financial Crisis, 1994-1995," in Sebastian Edwards and Moisés Naím (eds.), *Anatomy of an Emerging-Market Crash: Mexico 1994,* Washington: Carnegie Endowment for International Peace, 1998, p. 156.
[74] Ibid.

failing to comply with the decisions of the exchange rate commission.[75] This shows how the interests of the power bloc influenced the way in which central bank independence was implemented in the Mexican economy.

When the peso crisis occurred in 1994, the central bank also had to follow the Executive's policies to achieve economic stabilisation. While the 1994 peso crisis did not allow the Mexican central bank to function independently, it provided BANXICO with economic corroboration for the importance of 'sound money' and low inflation as primary goals of economic policy. The central bank is then able to externalise the imposition of financial discipline on wages, work processes, and social spending through a stronger set of rules and policy objectives.

The governor of BANXICO, for instance, has said that "if Mexico wants capital and stock markets that promote growth for the benefit of the majority, it is fundamental that we achieve price stability."[76] This is also expressed in the rules constraining government spending by limiting the amount of resources the government can draw from the bank. When the Mexican state exceeds the 1.5 limit it can borrow from the central bank, BANXICO issues government bonds that have to be paid by the federal government. This, in turn, makes the Mexican state even more dependant on capital markets, and for this reason, the Mexican central bank has incentives to enhance anti-inflationary credibility to make public debt more attractive. This is due to investors' preferences to hold currencies backed by anti-inflationary policies, facilitating

[75] Ley del Banco de México. D art. XXIII.

[76] Anonymous, "Mexico Must Achieve Price Stability," *Notimex*, 17 October 2000.

BANXICO's task of maintaining the worthiness of the peso, low inflation, and tight government spending.

The rules-based approach of the central bank underpinning the policies of low inflation and a strong peso has been implemented in a context where economic imperatives render future economic and monetary policy predictable. The *OECD Economic Survey: Mexico, 1997-1998* indicates that:

> The monetary policy framework ... is centred on an unambiguous commitment by the Central Bank to bring down inflation. The monetary programme announced at the start of each year sets the inflation target for the year, while the stock of primary money is used as an intermediate target, subject to an international reserve constraint. The more detailed policy formulation, increased transparency, and better communication about the rationale of policy actions should be helpful in promoting market confidence, while instruments to facilitate monetary management have been refined.[77]

Through a rules-based approach, BANXICO is able to deliver market expectations that are fulfilled. In this way, "prior patterns of market activity legitimate the central bank's decisions."[78] This can be seen in the central bank's main policy mechanism of the *corto* and inflation targeting. Through these mechanisms, the Central Bank assures investors that inflation will be controlled while interest rates and the worthiness of the currency are maintained at profitable levels.

In the particular case of inflation targeting, it has been argued that this anti-inflationary policy provides transparency to monetary policy. According to Ortiz, "the main strength of inflation targeting is to establish a transparent framework for the implementation of monetary policy that is useful as a marketing device, a communication

[77] Organisation of Economic Development and Cooperation, *Mexico, 1997-1998,* Paris, 1997, p. 3.
[78] Matthew Watson, "The Institutional Paradoxes of Monetary Orthodoxy: Reflections on the Political Economy of Central Bank Independence," *Review of International Political Economy*, 9: 1, 2002, p. 194.

tool, and a mechanism of accountability to the public at large."[79] The transparency and accountability of the Mexican central bank, however, remains questionable when one considers its very organisational structure. BANXICO's law has provided the conditions to insulate the central bank from public debate in the Mexican Congress. Although the Board of Governors can be required by Congress to attend congressional meetings so as to respond this branch's concerns regarding macro-economic policy, there are not mechanisms that compel the board to either answer the questions or implement the suggestions of Congress in central bank policies. Also, only the board of governors – appointed by the president – can remove the director of the central bank.[80] The independence of the central bank has therefore increased the power of the executive and state bureaucracy in relation to the Legislative power and partisan politics in general. The fact that BANXICO's independence releases this institution from policy bargaining with other political actors simplifies the monetary policy process. This, in addition to inflation targeting, provides the central bank with the mechanisms to respond rapidly to any changes in international financial markets. BANXICO, therefore, remains accountable only to financial investors rather than to Mexican citizens.

This shows how the Mexican central bank's control over financial conditions depends increasingly on its ability to affect market expectations. The autonomy of the Mexican central bank provides better conditions for this institution to conduct monetary

[79] Ortiz, "How Should Monetary Policymakers React to the New Challenges of Global Economic Integration," p. 269.
[80] Gabriel Szekeley, "Presentacion," en Gabriel Szekeley (ed.), *FOBAPROA e IPAB: El Acuerdo que No Debio Ser*, Mexico: Oceano, 1999, pp. 13-30.

policy, since it is able to impose policies that are not associated with the 'uncertainties' of the democratic processes.[81]

The independence of Mexico's central bank has also proved successful in assisting the state in preventing popular disapproval of monetary policies and avoiding direct responsibility over economic decision-making. Once the autonomy of this bank was approved by the Mexican congress in 1993, for instance, the major debate was whether BANXICO will in fact be able to be autonomous or the Executive would continue to dominate monetary policy. Issues of democratic accountability of economic policy were all but non-existent in the public debate.[82]

Also, the depolitisation of monetary policy through BANXICO's autonomy and anti-inflationary targets has helped the state to channel political conflict to secondary discussions that might not addresses class issues. The demands from political parties such as the PAN and PRD to liberalise the electoral process in Mexico preceded the questioning of monetary policy that became locked by the central bank in 1993. Likewise, when the peso crisis occurred in 1994, labour and capital blamed 'anonymous' speculators, the volatility of the global economy, or the timing of currency devaluation for Mexico's economic problems. This has also been reflected in the case of social movements. For instance, rural and urban debtors that were affected by high interest rates after the peso crisis created a movement called *El Barzon*. The organisation questioned the policies of high interest rates and the lack of credit for small enterprises

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[81] Gerald Epstein, "Political Economy and Comparative Central Banking," *Review of Radical Political Economics* 24: 1, 1992, p. 2.

[82] See: Carlos Acosta Córdova y Fernando Ortega Pizarro, "Prolongación del Monetarismo Salinista," *Revista Proceso*, 22 May 1993; Jorge Alcocer, "Banco de México: Autonomía," *Revista Proceso*, 5 June, 1993.

and the country-side.[83] The *Barzon*, however, failed to assess these policies in relation to the lack of accountability of the central bank, monetary policy, and the neoliberal politics of money.

It is worth noting that the autonomy of BANXICO is not an isolated case of the implementation of depolitisation of economic management. The Institute for Banking Savings, an institution that coordinated the bailing out of Mexican banks by the Mexican government in 1995, became an autonomous institution in the late 1990s.[84] By 2006, there were initiatives to grant independence to fundamental state economic agencies such as the Revenue Collection Agency (Sistema de Administración Tributaria, or SAT) and the National Commission of Banking Securities (Comisión Nacional Bancaria de Valores, or CNBV), a state agency responsible for the supervision of banks and other financial institutions. Its powers include: inspections of financial intermediaries; the issuance of general accounting principles and prudential regulation, such as credit and risk management procedures; and the intervention and imposition of sanctions. There is another initiative to reorganise the National Commission of the Retirement Saving

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[83] See: Carlos Acosta Córdova yFernando Ortega Pizarro, "Todos contra la Ususra y los Abusos de la Banca," *Revista Proceso,* 19 June 1993; Felipe Cobián, "Ya no Queremos Ser Victimas de la Usura Bancaria," *Revista Proceso,* 11 September, 1993; Samuel I. del Villar, "El Programa Económico del PRD," *Revista Nexos*, 1 November, 1993; El Barzón, *Declaración de Principios. II Congreso Nacional,* Mexico, 10 July 1999.

[84] After the privatisation of the banking system, banks increased the debt of both commercial banks and the non-bank private sector. As a result, the ratio of past-due loans to total loan rates escalated and the debt burden of the bank and non-bank private sector grew. This affected the financial groups' ability to repay their loans to their own banks and American investment firms, leading to a liquidity crisis in the Mexican financial system. To overcome the liquidity crisis, the Mexican state engaged in providing assistance to the domestic banking sector. The assistance package intended to provide banks with a dollar liquidity facility to stop and eventually reverse the run on the external liabilities of commercial banks. This relief took the form of dollar loans by the Mexican central bank, which was directed through the Banking Fund for the Protection of Saving (FOBAPROA) during Ernesto Zedillo's presidency (1994-2000). In 1999, the legal framework of the FOBAPROA changed, and it became the Institute for Banking Savings (IPAB). Assets under the custody of FOBAPROA became transferred to the new IPAB. Here, new notes were issued to replace the bonds held by FOBAPROA and to trade them in the open market.

System (Comisión Nacional del Sistema de Ahorro para el Retiro, or CONSAR) into an autonomous institution. The CONSAR is the Mexican regulatory body of private pension funds that sets operational risk management rules and specific time frames for the retirement fund managers.[85] If the restructuring of these state agencies takes place, the laws and regulations to collect revenues and oversee financial institutions will be left outside any mechanism of democratic accountability. Attempts to expand the depolitisation of economic decision-making in Mexico shows the ways in which the Mexican state attempts to further insulate economic policy from social demands in order to deepen neoliberalism in the country.

BANXICO, the Territoriality of the Mexican State, and Neoliberalism

The importance of analysing BANXICO and its anti-inflationary stance lies in the need to understand the dynamics and processes of change and the social content underlying institutional restructuring. The policies of the central bank are in fact key territorially-embedded processes through which the nation state constitutes global financial markets and reproduces market discipline within the Mexican nation-state. Through the anti-inflationary policies of the Bank of Mexico, Mexican labour, which is relatively immobile, becomes the anchor of the economy to guarantee low inflation, the worthiness of the peso, and profitable interest rates for national and international investors. Labour discipline, therefore, is another nexus between the nation-state and global financial markets.

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[85] Enrique Mendez y Roberto Garduño, "Inimaginable, autonomía del SAT: presidenta de la Cámara," *La Jornada,* 16 February 2006.

Central bank restructuring and the development of inflation targeting are, in fact, part of a neo-liberal recomposition of the capital relation in Mexico. Not only is labour disciplined, but the power bloc that emerged during the 1980s and 1990s has been able to translate their agenda of low wages, a stable peso, and profitable interest rates into an institutionalised political authority not by holding office, buying votes, and blackmailing, but by setting this fixed agenda through a rules-based approach and independence of BANXICO. The reflection of this neoliberal reconfiguration of social relations into the central bank shows the ways in which the state not only has exerted political control over the economy, but also how the state has carried out a political construction of market discipline within Mexico *via* the anti-inflationary policies of BANXICO.

Conclusions

An analysis of the restructuring of the Mexican central bank shows how BANXICO and monetary policy are pivotal in connecting global finance with Mexican economic policy making. The mediation of class conflict and the contradictions between the globality of capital accumulation and the national scale of state regulation within Mexico can only be achieved inasmuch as the Mexican state maintains the conditions under which it can repay its debt at profitable rates, keep inflation low, lower wages, and reproduce capitalist social relations within its own national territory.

This has been achieved by pursuing a strategy of depolitisation of economic management to enforce anti-inflationary policies and remove democratic accountability of economic policy while securing state earnings and private profits. As such, the autonomy of BANXICO and its anti-inflationary targets are not merely a response to

global financial constraints. Rather, "they are an attempt to impose new constraints by reconstituting the social basis of the domestic economy."[86] As the policy goals of price stability are secured within the legal framework of the central bank's independence, the so-called 'Mexican democratic transition' and the increased role of political parties is primarily formal. Economic policies have become less subject to partisan politics and societal demands, and the representation of citizens in governmental bodies has minimal effect on economic policy-making and altering the course of neoliberalism in Mexico.

[86] Watson, "The Institutional Paradoxes of Monetary Orthodoxy: Reflections on the Political Economy of Central Bank Independence," p. 194.

Part 3 Finance and the Scale of the Mexican State

Chapter 6

The Politics of Scale and the Territorial Reproduction of Capital

In order to understand the recent transformations of the Mexican economy, particularly between 1994 and 2006, it is necessary to account for the changing forms of territorial organisation that mediate and internalise the dynamics of the internationalisation of capital into the Mexican state. This is often concealed by debates that focus on methaphors such as internationalisation and regionalism *versus* the local and the national and emphasise a tendency towards the deterritorialisation of social relations in the nation-state and the prevalence of 'spaces of flow' over places.[1]

This chapter argues that the state is an expression of class relations, which is also spatially and socially constituted through the politics of scale. Scales of state governance – the region, the nation and the municipality – are in fact manifestations of the strategies of the state and social groups to extend and intensify capital's discipline over people and nature by creating social spatial regulations in which a scale is produced. More accurately, the process of state rescaling is associated with changes in class relations, articulated by particular class projects, and formed through class struggle. This, in turn, offers an understanding of the social agents and territorial processes that mediate and articulate the contradictory relationship between international accumulation and territorially-embedded national regulation.

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[1] See: Arjun Appadurai, "Disjuncture and Difference in the Global Cultural Economy," in Jonathan Xavier and Renato Rosaldo (eds.), *The Anthropology of Globalization*, Oxford: Blackwell, 2004, pp. 46-8; Manuel Castells, *The Rise of the Network Society*, Oxford: Blackwell, 1996.

The chapter first discusses the insights and limitations of different interpretations on regionalisation and sub-national regional development. Second, the relationship between the internationalisation of capital and the constitution of political scales of the state are examined. Third, the chapter shows how the state has shifted the scales of economic governance upward and downward to intensify accumulation and reproduced the nation-state as an 'imagined' economy, which is expressed through a national balance-of-payments.

Regionalisation and Regional Development: The End of the Nation-State?

The internationalisation of capital has been accompanied by the constitution of several regional blocs: the Asian bloc, the EU, and NAFTA. This trend towards regionalism has raised questions of why new forms of production, trade, and financial transactions are emerging in a regional context. The economic rationalist approach on regional integration is based on the premise that countries should specialise in the production of commodities in which they have a comparative advantage. This comparative advantage can include commodities that use factors of production (e.g. land, labour, and capital) that are relatively more productive or abundant in that country.[2] In other words, nations with different endowments of capital, labour and natural resources gain by specialising in those areas where their relative costs of production are low and importing in those areas where their relative costs of production are high. As export and income growth leads to higher savings, developing countries catch up with industrialised economies.

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[2] Malcom Gillis, et al., *Economics of Development*, New York: W.W. Norton, 1996, pp. 416-17.

The economic rationalist account of regional integration also emphasises the role of market forces in reorganising nation-states into regions. Keinichi Ohmae, for instance, argues that region-states are largely defined by their economic activity rather than by their political borders.[3]

> Region states are natural economic zones. They may or may not fall within the geographic limits of a particular nation – whether they do is an accident of history. Sometimes these distinct economic units are formed by parts of states, such as those in northern Italy, Wales, Catalonia, Alsace-Lorraine or Baden-Württemberg. At other times, they may be formed by economic patterns that overlap existing national boundaries, such as those between San Diego and Tijuana, Hong Kong and southern China, or the growth triangle of Singapore and its neighbouring Indonesian islands. In today's borderless world these are natural economic zones and what matters is that each possesses, in one or another combination, the key ingredients for successful participation in the global economy.[4]

For this reason, the economic rationalist version of regional integration suggests that comparative advantages should guide and organise the economy rather than state intervention.

The experience of state-led economic growth in the Association of South East Asian Nations (ASEAN) has challenged the economic rationalist approach in several ways. These countries implemented state-led strategies to assist domestic exporters who were catching up with the organisational forms and new technologies of the United States.[5] According to the neo-Weberian analysis, states have been able to adapt these countries to the informational technology, which is "characterized by its interdependence,

[3] Kenichi Ohmae, *The End of the Nation State: The Rise of Regional Economies*, New York: Free Press, 1995, p. 110.
[4] Kenichi Ohmae, "The Rise of the Region State," *Foreign Affairs*, 72: 2, 1993, pp. 78-9.
[5] See, for example: Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization,* Princeton: Princeton University Press, 1990; Peter Evans, *Embedded Autonomy, States and Industrial Transformation,* Princeton: Princeton University Press, 1995.

its asymmetry, its regionalization, the increasing diversification within each region, its selective inclusiveness, and its exclusionary segmentation."[6]

As such, the emergence of regional structures of governance has been determined by the need to create technological advances.[7] The regional differentiation created by the informational economy, according to Castells, has also been the result of state intervention in guiding competitiveness through technological innovation and skill training.[8] Castells also argues that regional blocs are networks of interactions of shared sovereignty better suited to deal with 'spaces of flow.' Regionalisation, therefore, creates "a new form of state, a network state, one whose key features is a unified economy, not just a trading bloc."[9]

The Marxist analysis of regionalism focuses on issues of production and the political and social nature of regional integration. According to David McNally, regional blocs are competing centres of accumulation that have a dominant national power.[10] Henry Veltmeyer, James Petras, and Steve Vieux argue that "the strategic economic needs of the U.S. state" in its competition with Germany and Japan have been decisive in the process of regionalisation.[11] Regional bloc formation has enabled the United States to offset part of its deficits with Asia and Europe, thereby buffering its decline in global

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[6] Manuel Castells, *The Rise of the Network Society*, Oxford: Blackwell, 1996, p. 106.
[7] Ibid., p. 411.
[8] Manuel Castells, *The End of the Millennium,* Oxford: Blackwell, 1998, p. 282.
[9] Castells, *The Rise of the Network Society*, p.111.
[10] David McNally, "The Present As History: Thoughts on Capitalism at the Millennium," *Monthly Review*, 51: 3, 1999, p. 138-9.
[11] Henry Veltmeyer, James Petras and Steve Vieux, *Neoliberalism and Class Conflict in Latin America: A Comparative Perspective on the Political Economy of Structural Adjustment*, New York: St. Martin's Press, 1997, p. 106.

competitiveness.[12] The debate addresses the way in which global capitalism is taking shape through the competitive relations among regionally-based capitals. Through trade agreements, parts of the world are integrated into these regions in subordinated positions, which reflect the imperialist dynamics of global capitalism. According to this view, this is the case of NAFTA and the initiative of the Free Trade of the Americas. This theoretical position also stresses that regional agreements enhance transnational capitalist power and profits at the cost of growing economic instability and deteriorating working and living conditions.[13] The integration that takes place through regional trade agreement often protects business interests by protecting intellectual property rights, guaranteeing investment opportunities, and facilitating the movement of goods, thereby affecting the living conditions of localities. "Thus, regional integration, rather than competing with and standing in the way of a free and open global economy, is providing an intermediate step consistent with corporate globalization".[14]

While regionalisation is considered an important aspect of the global economy, these debates have also accounted for the ways in which internationalisation has compelled the reorganisation of the economy into sub-national processes. In this respect, economic rationalist and neo-Weberian theories have been influential in economic and urban planning. The economic rationalist analysis addresses this question by looking at issues of economic growth and regional disparities within nation-states. The economic rationalist approach, based on Robert Solow's growth model, argues that technical

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[12] William K. Tabb, "Capital, Class and the State in the Global Political Economy," *Globalizations*, 2: 1, 2005, p. 57.
[13] See: Martin Hart-Landsberg, "Neoliberalism: Myths and Reality," *Monthly Review*, 57: 11, 2006.
[14] William K. Tabb, *Economic Governance in the Age of Globalization*, New York: Columbia University Press, 2004, p. 372.

progress is both a cause and effect of growth: "the stimulation of investment will favour faster intermediate-run growth through its effect on the transfer of technology from laboratory to factory."[15] Regional growth depends upon the growth rate of capital stock, labour force and technology. In this model, regions with a high capital/labour ratio will have an inflow of labour and a low yield on investment, whereas regions with low capital/labour ratios will have an outflow of labour and high yield investment.[16] In this view, the overall rate of output is driven by technological progress.

When regions have low levels of technology, they can transfer this technology at a low price. As a result, low-technology regions will have fastest growth per worker. A high-technology region, in contrast, can only increase growth by investing in new knowledge at a higher cost.[17] In general, this theory suggests that regional disparities will disappear in the long run, since capital will flow from high-wage to low-wage regions, labour will migrate to high wage regions, and poor regions will benefit from technological catch-up. This eventually will lead to the equalization of returns to capital, labour and technology, and convergence among regions within nation-states.

Neo-Weberian approaches, in contrast, argue that regional disparities are not disappearing. Industrialisation inevitably produces regions which are produced by endogenous factors rather by exogenous placement of resources and consumers.[18] The characteristics of these regions depend on "what we might call a new 'holy trinity' of

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[15] Robert Solow, "Growth Theory and After," *American Economic Review*, 78, 1998, p. 137.
[16] Harvey Armstrong and Jim Taylor, *Regional Economics and Policy*, Oxford: Blackwell, 2000, p. 73.
[17] Armstrong and Taylor, *Regional Economics and Policy*, p. 79.
[18] Michael Storper and Richard Walter, *The Capitalist Imperative*, New York: Blackwell, 1989, p. 70.

technologies-organizations-territories."[19] According to Michael Storper, technological change alters the costs of production, including their location. Also, firms rely on networks and groups that tie together the production system, which refers to the notion of organisations. Territories, in turn, can be characterised by "strong or weak local interactions and spillovers between factors, organizations and technologies."[20] These dynamics are in turn affected by the new forms of post-Fordist production organization, particularly vertical disintegration. Vertical disintegration is defined as "the general process of fragmentation of different elements of the labour process into specialized but functionally interlinked units of production."[21] Faced with vertical disintegration, and depending on the organizational, territorial, and technological factors, firms will tend to invest in locations close to other industries so as to cut the costs of transaction.[22]

These processes are often illustrated with the economic organisation of Southern California, which is seen as a successful case of agglomeration, technological development and interaction among territories. For this reason, the neo-Weberian analysis suggests the emulation of the same model of regional development in this part of the US. Storper, for instance, argues that it is necessary to promote macro-economic policies that allow for descentralisation, investment in new sectors (particularly informational technology), scale increases in existing industries, the creation of growth-

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[19] Michael Storper, *The Regional World: Territorial Development in the Global Economy*, New York: Guildford Press, 1997, p. 26.
[20] Storper, *The Regional World,* p. 26.
[21] Allen Scott, "Industrialization and Urbanization: A Geographical Agenda," *Annals of the Association of American Geographers,* 76, 1986, p. 27. See also: Michael Storper, *Industrialization, Economic Development and the Regional Question in the Third World,* London: Pion, 1991, pp. 12-3.
[22] Scott, "Industrialization and Urbanization," p. 28; Michael Storper and Richard Walter, *The Capitalist Imperative*, New York: Blackwell, 1989, pp. 70, 84.

peripheries, and the agglomeration of urban labour markets in order to avoid regional polarisation.[23] In general, the neo-Weberian approach to regional development suggests that state policies should be oriented towards adaptation and promotion of the new technological-institutional regime of production based on flexibility.[24]

While the 'region' as a concept and a form of organisation at the supranational and subnational level has gained importance in political science, the theorisation of regionalism and regional development takes for granted the constitution of these political scales. In the case of the economic rationalist approach, the region is seen as a more adequate form of organisation than the state in the context of 'borderless' flows of goods and money. This account, however, is problematic because it ignores that nation-states have been central to the creation and enforcement of a regional framework to further secure investment and property rights. The neo-Weberian perspective sees the region as determined by technological innovation promoted through the 'shared sovereignty' of the state. Still, regionalisation is seen as an inevitable outcome of informational capitalism that compels states to organise themselves into technological-driven and competitive trade blocs. In this way, regionalisation becomes a process that takes places across nation-states rather than within them.[25] In general, these two perspectives suggest that global markets and technology are the main forces driving the 'inevitable' constitution of regions. The region is seen as a "pre-existing entity with the potential to be turned into a

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[23] Michael Storper, *Industrialization Economic Development and the Regional Question in the Third World,* London: Pion, 1991, p. 98.
[24] Flexibility is defined as the dynamics of production that allow for prompt shifts from one process to another and rapidly adjusts quantities of output. Storper, *Industrialization Economic Development and the Regional Question in the Third World,* p. 107.
[25] Wendy Larner and William Walters, "The Political Rationality of 'New Regionalism': Toward a Genealogy of the Region," *Theory and Society,* 31: 1, 2002, p. 409.

central element of global markets."[26] Such a conception of the region, however, tends to conceal and neutralise the power relations behind the construction of regional blocs.

Marxist approaches have, in contrast, addressed how the region is a process driven by power structures of the state. The Marxist view also accounts for the ways in which competition operates within trading bloc and its impact on inequalities within the region. While these approaches implicitly discuss issues of uneven regional development, their analysis is still limited to explanations of increasing labour exploitation, deterioration of wages, and social polarisation within regional trade blocs. In order to advance the Marxist approach of uneven regional development, it is necessary to examine the ways in which state governance is re-scaled and how this produces changes in the organisation and categorisation of concrete spaces within the nation-state.

In the case of sub-national regionalisation, the economic rationalist approach emphasises that the dismantling of differences is a pre-condition for the proper functioning of market mechanisms, the creation of regional convergence, and the homogenisation of space for capital accumulation and circulation. Still, arguments about convergence rely on misleading assumptions of free mobility of all factors of production between regions. In this framework, labour is compared with goods, ignoring that workers are part of larger communities embedded in fixed environments. Due to this presupposition, this perspective fails to explain why regional disparities persist over the long run, particularly the rate of savings and wages. The neo-Weberian framework, on the contrary, accounts for the regional disparities as a constant trend. Space is conceived

[26] Larner and William Walters, "The Political Rationality of New Regionalism," p. 391.

as having universal characteristics, where differences among territories and their hierarchical relations are determined by the organisation of production and technological progress. Despite considerations of institutions, technology, and production, neo-Weberain explanations are often based on 'success' stories in the technology sector, concealing the negative impacts of the development of these sectors and the reorganisation of production, particularly on labour and communities. The neo-Weberian approach, for instance, ignores that clusters are, in fact, a form of industrial organisation that fragments labour, flexibilises labour conditions, widens the incomes gap and increases social polarisation.[27]

Overall, these perspectives see the emergence of economic regions as a response to financial mobility, technological innovation, the decline of state power, competition among powerful states, or the surfacing of a "post-national world."[28] In general, these debates do not explain why there are simultaneous reconfigurations of national, local or regional politics. The lack of understanding of the emergence of this simultaneous restructuring derives from the fact that the construction of these political scales are taken for granted. This, therefore, neutralises the power relations that constitute each level of governance.

Internationalisation of Capital and the Politics of Scale

The national form of the nation-state and the global dimension of capital are both mutually constitutive and contradictory within the capitalist mode of production.

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[27] Edward Soja, *Postmetropolis: Critical Studies of Cities and Regions*, Oxford: Blackwell, 2000, pp. 173-4.

[28] See: Arjun Appadurai, "Sovereignty Without Territoriality: Notes for a Postnational Geography," in Patricia Yaeger, (ed.), *The Geography of Identity,* Ann Arbor: University of Michigan Press, 1996.

Although capital circulates internationally, the class relations necessary for the production and reproduction of value occur through, and manifest themselves in, the form of the nation-state. As such, the international scale in which capital moves, and the national scale that regulates it, cannot be considered as given. Accumulation, as mentioned in previous chapters, relies on the reconfiguration of space to annihilate space and accelerate capital accumulation. The territorial landscape and the capitalist social relations embedded in accumulation are not necessarily transformed by the movement of money and commodities themselves. Such a transformation requires the intervention of the state. More precisely, the internationalisation of capital is articulated through space – specifically through the territoriality of the nation-state and the scale processes that the state constitutes. Without the territorially-bounded political and institutional management of the state that regulate and secure markets, both money and capitalist relations disintegrate.

Henri Lefebvre argues that the state is organised spatially, and consequently state intervention is directed to regulate territorially embedded social relations.[29] State institutions influence and secure socio-economic relations within a territorial fix. These interventions then take the form of the construction and reproduction of political scales.[30] A critical approach to the politics of scale allows an understanding of the 'local,' the 'regional.' and the 'national' as "the extent to which the regulation and command of territorially embedded social relations expand over a certain material/social space and

[29] Henri Lefebvre, "Space and the State," in Neil Brenner, et al. (eds.), *State/Space*, Oxford: Blackwell, 2003, pp. 84-100.
[30] Eric Swyngedouw, "Globalisation or Glocalisation? Networks, Territories and Rescaling," *Cambridge Review of International Affairs*, 17: 1, p. 32.

operate over certain distance."[31] Scalar politics redefine the relationship between state power and citizens and become the organiser of territory and expression of social action.[32]

A political scale is socially constituted rather than a pre-given and defined natural unit of human existence. Consequently, a political scale is never fixed, and hence ontological priority never resides in a specific scale.[33] As Eric Swyngedouw notes, the theoretical and political priority is to understand how political scales of governance are constituted through social relations and the state, and how scales change social power relationships.[34] If political scales are always constituted through social processes, then they are also subjected to contestation. For this reason, political scale is never static. There is no unidirectional or hierarchical relation between scales, but rather scales co-exit simultaneously in different orders.[35] Political scales can, therefore, be transformed because "they are contested and restructured in terms of their extent, content, importance, or interrelations."[36]

The constitution and reorganisation of scale is central to the implementation of social strategies to control resources. The state's ability to command power and authority becomes pivotal to impact and situate itself and other social groups at different political scales. This occurs through the creation and reproduction of different scales of decision-

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[31] Eric Swyngedouw, "Excluding the Other: the Production of Scale and Scaled Politics," in Roger Lee and Jane Willis (eds.), *Geographies of Economies*, London: Arnold, 1997, p. 169.
[32] Neil Smith, "Remaking Scale: Competition and Cooperation in Pre-National and Pot-National Europe," in Neil Brenner, et al. (eds.), *State/Space*, Oxford: Blackwell Publishers, 2003, p. 228.
[33] Eric Swyngedouw, "Neither Global nor Local: Glocalisation and the Politics of Scale," in Kevin Cox (ed.), Spaces *of Globalisation: Reasserting the Power of the Local*, New York: Guilford Press, 1997, p. 140.
[34] Ibid., p. 140.
[35] Richard Howitt, "Scale and the other: Levinas and Geography," *Geoforum*, 33: 3, 2002, p. 306.
[36] Swyngedouw, "Globalisation or Glocalisation? Networks, Territories and Rescaling," p. 33.

making and regulatory structures.[37] Through these structures, state regulation over space can be re-scaled even if the national boundaries are relatively fixed. State intervention can be reoriented towards different socially constituted scales such as the regional level of the international or sub-national levels – the city, the municipality, or the state.[38] In this way, the organisation of space under capitalism operates at a variety of scales of decision-making, which create the conditions to materialise capitalist power relations in particular geographies.

Shifting Scale Upwards and Downwards: The Scalar Politics of Neoliberalism

Political scale is, therefore, integral to social strategies of control, and political rescaling can be materially manifested in jurisdictional, administrative, and regulatory structures. An example would be the political scale created by regional free trade agreements. The rescaling of the state through regional agreements is the expression of the mechanisms of competition and accumulation at a wider scale. When an individual capital encounters national declining conditions of profitability, the national scale of state regulation and capitalist reproduction might pose obstacles for the territorialisation and deterritorialisation of capital. While the national scale is a regulatory space that secures accumulation and property relations, a greater scale of state power provides a wider territorial scope for attempting to guarantee profitable conditions for capitalist reproduction. As a result, the upward rescaling of the state provides the legal and regulatory setting that further secures the territorialisation of capital in a larger area.

[37] See: Dennis Judd, "The Case of Missing Scales: A Commentary on Cox," *Political Geography*, 17: 1, 1998.
[38] Swyngedouw, "Excluding the Other: the Production of Scale and Scaled Politics," p. 171.

The upward rescaling of the state not only influences the form of state power, but also the way in which labour and production is organised within the nation-state. Labour as well experiences a reorganisation of its workplace and their local contexts in the form of changing patterns of production and public policies that emerge from up-scaled forms of governance. Capital can organise production regionally and change previous locations of production to cheaper areas within the region or to locations closer to a company's headquarters. Public policies can alter the urban landscape through infrastructural development and weaken environmental and labour standards to compete for investment within the region. These processes transform local landscapes in the form of environmental degradation, unemployment, and migration.

This reorganisation of spaces of regulation often involves discretionary management. While the acceptance of the rescaling of the state through regional trade agreements might be open to public debate, the content of scale restructuring is entirely left as discretionary to state and corporate elites.[39] Decisions about which regulations and clauses are included or excluded in the agreement are confined to the resolutions of state managers and a small elite. Such resolutions are framed as neutral technicalities that only a group of experts can resolve.[40] The issue of scale restructuring is thus seen as an economic rather than a political or social issue.

One of the most relevant changes in terms of state policy is the creation of what Ricardo Grinspun and Robert Kreklewitch call a "conditioning framework" through the

[39] Smith, "Remaking Scale: Competition and Cooperation in Pre-National and Post-National Europe," pp. 233-4.
[40] Jonas and Ward, "Urban Policy Under Capitalism," p. 22.

upward shift in the scale of state governance. This rescaling often limits the range of political venues in which citizens can participate in economic policy-making.[41] As such, the possibility of changing policies and regulations embedded in regional agreements *via* national politics is precluded. Due to the 'locking-in' of regional policies into this framework, national regulations are directed along neo-liberal regional lines, but the specific implementation and content remains nationally dependant.[42]

By containing policies and regional clauses within a wider state apparatus, decision-making becomes more remote, depersonalising public policy and economic management.[43] These structures define who is excluded from participating and who benefits from public policy and the rescaling of the state. The upward process of rescaling of the state further conceals the political nature of scales and the decision-making process contained in them. While the upward shift of state governance provides the legal and regulatory setting that secures capital and allows for its reproduction, this depersonalisation of state policy isolates policies from societal pressures that contest state alignment with the interests of capital.[44]

State governance may also be rescaled downwards. This is reflected in the state's role in coordinating local and regional institutions within the nation-state. The restructuring of political scale downwards often involves the partial devolution of state capacity from national to local governments in order to boost local productivity and

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[41] Ricardo Grinspun and Robert Kreklewitch, "Consolidating Neoliberal Reforms: Free Trade as a Conditioning Framework," *Studies in Political Economy,* 43, 1994, p. 36.
[42] Grinspun and Kreklewitch, "Consolidating Neoliberal Reforms: Free Trade as a Conditioning Framework," p. 39.
[43] Jaime Gough, "Changing Scales as Changing Class Relations: Variety and Contradiction in the Politics of Scale," *Political Geography*, 23: 1, 2004, pp. 194-9.
[44] Gough, "Changing Scales as Changing Class Relations," p. 199.

competitiveness. There is also a strengthening of 'entrepreneurial states' through the "creation of new markets and the deepening of pro-growth, supply side strategies."[45] In the process of shifting political scale downwards, local states and territories might ally with other territorial entities – even across national regions and borders – to remain competitive.[46] Local states, in the process of re-scaling, can be increasingly permeated by the role of business in the design and the evaluation of state policies.

Such rescaling cannot, however, be assessed as the consequence of the weakening of the nation-state or organisational changes directly created by global markets. This shifting of scale downwards complements upward scales of governance. As the regulation of the wage at the national level becomes more complex and subject to social contestation in the context of the internationalisation of capital, the downward scale of governance is an effective mechanism to flexibilise labour conditions and contain class struggle.[47] For this reason, the state has undertaken measures towards the decentralisation of labour and economic regulation. Local policy has a greater ability to deal with the political and social tensions that come with capital accumulation. For instance, "policies directed at improvements in local profitability encourage capital to be more spatially loyal."[48] Unlike competition among countries, the national politics of regional and local development also attenuate the struggle for investment by localities through practices such as revenue-sharing with the central state. Kevin Cox argues: "This

[45] Gough, "Changing Scales as Changing Class Relations," p. 198.
[46] Jonas and Ward, "Urban Policy Under Capitalism," p. 19
[47] Swyngedouw, "Globalisation or Glocalisation? Networks, Territories and Rescaling," p. 38.
[48] Jamie Gough and Aram Eisenschitz, "The Construction of Mainstream Local Economic Initiatives: Mobility, Socialisation and Class Relations," *Economic Geography*, 72: 2, 1996, p. 183.

combination is often marked by downward intervention by central branches of the state in order to plan for more effective national competitiveness."[49]

These strategies are aimed at promoting workers' collaboration with capital to enhance production efficiency within the workplace.[50] This can take the form of policies of regional development that seek to strengthen the competitiveness of the territory's capital through regulations and subsidies. Such policies allow for increasing productivity and low production costs, including infrastructure and labour costs. As Jamie Gough argues:

> … the premise of this strategy is that jobs will be secured and enhanced through enabling the capital within that unit to compete better against capital elsewhere: the workplace against rival workplaces, the regional industry against competitor regions, and so on.[51]

Through the local scale, the state and the private sector can frame job insecurity as a local problem that has a local solution. This is often expressed in policies that lead to the deterioration of working conditions to raise local competitiveness. The needs of particular groups can then be subordinated to maximise accumulation in the locality as a whole. In this manner, the locality has a disciplinary effect, since it intensifies competition within the nation-state. At the same time, local scales of economic governance mediate the processes of the territorialisation of capital.

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[49] Kevin Cox, "Introduction: The Politics of Local and Regional Development," *Space and Polity*, 9: 3, 2005, p. 196.
[50] Jamie Gough, "Workers' Strategies to Secure Jobs, their Uses of Scale, and Competing Economic Moralities: Rethinking the 'Geography of Justice'," *Economic Geography Research Group Working Papers*, 2002, p. 9.
[51] Gough, "Workers' Strategies to Secure Jobs, their Uses of Scale, and Competing Economic Moralities," p. 9.

While the upward scaling of the scale removes politics from the process of economic decision-making, the local scale also depoliticises and depersonalises the effects of the market on workers. Pressure of competitiveness and productivity that pose a threat on workers' jobs, and local labour conditions in general, are made to appear as the outcome of decreasing competitive advantages in a given locality or as the lack of workers' skills and productivity. Thus, the deterioration of local working conditions and employment prospects appears as the result of 'impersonal' and neutral market selection of more competitive places rather than the outcome of capitalists' class power. In general, the downward reorganisation of state governance constructs the imperatives of global discipline in a 'local' way.[52] In other words, local and regional competitiveness based on flexibilisation of working conditions are constructed as a requirement imposed by global markets rather than a political strategy to maintain high levels of profitability in the locality.

The creation of upward and downward scalar processes and fixes are key to mediating and temporarily solving the contradictions imposed by uneven development. On the one hand, the state promotes territorialisation of capital within a certain locality, region, or a nation by expanding state power over distinct geographical spaces. The constitution of a particular scale within the nation-state often involves the creation of a fixed infrastructure that gives a 'structured coherence' to the process of accumulation in a given space. By structural coherence, David Harvey refers to the ability of physical infrastructure to give spatial unity to transportation, housing, work places and state

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[52] Philip F. Kelly, "Globalisation, Power and the Politics of Scale in the Philippines," *Geoforum*, 28: 2, 1997, p. 160.

institutions for capital accumulation to proceed.[53] Through the implementation of this structural coherence in particular territories within the national space, the state attempts to homogenise the conditions of economic growth and create specialised competitive advantages in each region or locality.

However, state intervention in territorialising capital in the process of rescaling can only reproduce the logic of uneven development. The state simultaneously encourages capital de-territorialisation not only in other nation-states, but also within the national scale of regulation due to the dynamics of capitalist competition. As Cox notes, while countries compete with one another, localities also compete among each other within the territorial confines of the nation-state. This implies simultaneous de-territorialisation at one geographical scale and territorialisation of capital in another locality within the same nation-state.[54]

Thus, state intervention through the politics of scale tends to amplify unevenness, allowing capital to play one local or regional or national class configuration off against others.[55] As a whole, the state attempts to mediate the tensions between the territorialisation and deterritorialisation of capital politics of scale by constantly changing the extent of regulation and reproduction of capitalism in order to territorialise capital within a spatial fix. Yet, this scalar intervention only reasserts the contradictions between fixity and motion of capitalism in the process of uneven development.[56]

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[53] David Harvey, *Spaces of Global Capitalism: Towards a Theory of Uneven Geographical Development*, London: Verso, 2006, p. 102.
[54] Cox, "Introduction," p. 196.
[55] David Harvey, *Justice, Nature and the Geography of Difference*, Oxford: Blackwell Publishers, 1996, pp. 296-8.
[56] Harvey, *Spaces of Global Capitalism,* p. 106.

The Imagined National Economy and Balance-of-Payments

The constitution of upward and downward scales of regulation does not represent the decomposition of the national form of the state. While the national scale cannot be considered either as exclusive or natural space for the circulation and reproduction of capital, it remains pivotal to reproducing capitalist social relations in the world market. The state organises and reproduces international accumulation at the national scale through policy making, and the construction of other political scales. The nation-state, therefore, continues directing local development initiatives and plays an important role in the creation of 'poles of competition' and free trade agreements through state legislation.[57]

The nation state is a distinct political scale, since it is historically and socially portrayed and collectively experienced as an 'imagined' community. According to Benedict Anderson, members imagine the nation as collective experience, even though these same members might not share the same living conditions, the same activities, or know each other. The nation is therefore "imagined as a community because [it] is conceived as deep, horizontal comradeship."[58]

According to Anderson, nations developed as a necessary component of capitalist society.[59] Lefebvre notes that the nation involves the development of a market over a historical period, which produces a space embodying a hierarchy of places and the emergence of a political power that controls and exploits natural resources and the

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[57] Delphine Ancien, "Local and Regional Development Policy in France: Of Changing Conditions and Forms, and Enduring State Centrality," *Space and Polity*, 9: 3, 2005, p. 237.
[58] Benedict Anderson, *Imagined Communities: Reflections on the Origin and Spread of Nationalism*, New York: Verso, 1991, pp. 6-7.
[59] Ibid., p. 65.

growth of productive forces.[60] The economic dimension of this 'imagined' community also includes the geographically immobility of labour, which points to the role of the modern nation-state in homogenising space for the circulation of commodities and capital.[61]

Historically, the modern concept of the nation has been socially bounded up with the state. First, the state expresses the nation materially by establishing the equality and freedom of exchangers of commodities, the owners of labour-power and capital. As such, labourers and capitalists appear in the political sphere not as social classes but as individual political subjects. The nation-state is, therefore, presented as unity of these individuals with non-hierarchical relationships that exists within an 'imagined' community.[62] Second, the nation-state remains the political expression of the capital-labour relation that takes place internationally, despite their concealment behind notions of 'political equality.' Class conflict and gains do not take place exclusively – or even predominantly – in the workplace or globally, but rather in national political structures.[63] By looking at the national construction of the state, state institutions are mobilised in different ways to regulate and organise socio-economic relations.

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[60] Henri Lefebvre, *The Production of Space*, Oxford: Blackwell, 2001, p. 114.
[61] However, capitalism in itself did not create or shape these imagined communities, since there are other factors, such as history, symbolism, and traditions, that are central in the constitution of nationhood. Anderson, *Imagined Communities*, p. 65.
[62] Nicos Poulantzas, "The Nation," in Neil Brenner, et al. (eds.), *State/Space*, Oxford: Blackwell Publishers, 2003, p. 66.
[63] Benedict Anderson, "Introduction," in Benedict Anderson and Gopal Balakrishnan (eds.), *Mapping the Nation*, New York: Verso, 1996, p. 7.

The form of intervention is also dependent on spatial imaginaries that represent political spaces and differentiate states and their economies from others.[64] Considerations of the economic dimension of the nation, as discussed in the work of Nicos Poulantzas or Dick Bryan on the 'imagined' economy, provide a framework to understand how processes of economic change are articulated at the global and national level. This notion of the 'imagined' economy shows the mechanisms of political legitimation of changing economic policies as well as the strategies of economic integration that articulate the nation-state to a regional and global environment.

The notion of 'imagined' economy is particularly important in the current context since the national scale remains created and recreated through finance and the state despite recent internationalisation. Money in the form of paper or electronic currencies reproduces the national scale of state governance by creating a national attachment "despite the fact that national moneys are issued and circulate outside the national jurisdiction." [65] The concept of the national economy has also been privileged by economists and policy-makers for practical reasons. The nation-state as an economic unit allows for a definition of a space with a common currency, common laws, and institutions that comprise important national aggregates such as output, employment, investment, consumption, interest rates, real wages, price level, and money supply.[66]

These national aggregates are the most evident representation of the national space of the economy, and they are partly comprised by the balance-of-payments

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[64] Neil Brenner, et al., "Introduction : State Space in Question," in Neil Brenner, et. al. (eds.), *State/Space*, Oxford: Blackwell, 2003, p. 6.
[65] Dick Bryan, "Global Accumulation and Accounting for National Identity," *Review of Radical Political Economics*, 33: 1, 2001, pp. 64-5.
[66] Hugo Radice, "The National Economy: A Keynesian Myth," *Capital and Class*, 22, 1984, p. 116.

accounts. Balance-of-payments are based on Keynesian national accounting methodology. Under this assumption, the national economy as a unit can carry out an autonomous accumulation and regulation. This framework of national accounting also suggests that the state has the capacity to adjust the capital account to the current account in order to balance each other. The external sector, in this rendering, only adds to or subtracts from the national economy.[67] This system of national accounting and balance of payments remains the primary statistical representation of the national economy despite financial internationalisation.[68]

As a whole, the Keynesian view of national accounting requires a high level of financial autonomy and presupposes a geographical coherence of the nation-state and its currency. This schema seemed coherent with the capital controls and fixed-exchange rates that prevailed during the Bretton Woods period. This no longer seems to be the case, particularly in a context of financial engineering and international transactions.[69] This is more evident when one considers that a foreign currency is not determined solely through its relation to commodity capital of trade.[70]

The problems of Keynesian notions of balance-of-payments are not only confined to their disregard for sophisticated financial instruments. Other problems arise when policies that emerge from balance-of-payment are considered. During the Keynesian era, balance-of-payment became a policy tool to create and shape macro-economic policies of demand management. Demand management, however, is no longer the primary goal of

[67] Bryan, "Global Accumulation and Accounting for National Identity," p. 65.
[68] Ibid., p. 70.
[69] Peter Garber, "Derivatives in International Capital Flows," *National Bureau of Economic Research Working Papers Series, 6623,* Cambridge: NBER, 1998, pp. 33-4.
[70] Garber, "Derivatives in international Capital Flows," p. 34.

monetary policy, since demand is considered international.[71] Instead, a micro-economic view of national competitiveness has become the centre of attention of the present state policy, which has no longer a domestic orientation, but rather is outward-looking in principle.[72] This in itself, when coupled with off-balance sheet financial transactions, makes a national currency difficult to define and measure. While Keynesian economics do not guide economic policy, there is a reliance on Keynesian national accounting and national categories, which create and recreate a representation of the national economy.

This becomes highly problematic when one factors in the logic of competitiveness (which is itself based on national accounts). Competitiveness, of course, is a micro-economic attribute traditionally applicable to firms.[73] However, the concept has recently been extended to states.[74] This has meant a fundamental shift in state behaviour. The state is now required to secure the profitability of individual industries exposed to global accumulation.[75] Also, when competitiveness is measured in national categories in a macro-economic framework, competitiveness is associated with overall national gains.[76] This reflects what Charles Gore calls methodological nationalism. Here, the explanatory

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[71] Bryan, "Global Accumulation and Accounting for National Identity," p. 65.
[72] Dick Bryan, *The Chase Across the Globe: International Accumulation and Contradictions for Nation States*, Boulder: Westview Press, 1995b, pp. 162-4.
[73] As Michael Porter argues: "Competition is at the core of the success or failure of firms. Competition determines the appropriateness of a firm's activities that can contribute to its performance, such as innovations, a cohesive culture, or good implementation. Competitive strategy is the search for a favorable competitive position in an industry, the fundamental arena in which competition occurs." *Competitive Advantage: Creating and Sustaining Superior Performance,* New York: Free Press, 1998, p. 2.
[74] Bryan, "Global Accumulation and Accounting for National Identity," p. 70.
[75] Ibid., p. 69.
[76] Ibid., p. 70.

framework that measures a country's economic performance is national, while its normative framework remains global.[77]

The ways in which the state represents the national scale of the economy also have consequences on state economic intervention. In the international measuring of national categories, which can themselves be considered social and class processes, capital and labour have to meet international standards. While capital has to reach standards of profits occurring in international exposed markets, workers, in contrast, have to adhere to labour conditions that allow for these profits.

'National competitiveness,' which is constructed through the notional idea of the 'national economy,' produces policy provisions that allow for the reproduction of capitalist social relations. These social relations simultaneously construct competitiveness and economic performance nationally. While money and commodities are mobile, labour is more immobile. Labour is thereby rendered as the main target of government policy to improve national competitiveness. The national construction of the economy complements economic rationalist monetary policies that seek to prevent inflationary pressures through low wages. The nationality of the economy provides a basis to promote the interests of capital, particularly the internal bourgeoisie, to the peril of labour/the population as a whole. This is done by locating private ownership and private gain, and associating them with a national collective benefit.

An example of this is the national debt which is generated by private sector borrowing. This national debt appears as a national liability in national accounts even

[77] Charles Gore, "Methodological Nationalism and the Misunderstanding of East Asian Industrialisation," *European Journal of Development Research*, 8: 1, 1996, pp. 3-5.

though the nation-state does not have legal responsibility over this borrowing. This liability, therefore, is presented as a contribution to national production that provides employment despite the fact that this private borrowing might have been used to buy financial assets in international markets.[78] The national connotation of private debt also provides a justification to argue that the population is living beyond its means and that state policy needs to be directed towards fiscal austerity and tighter monetary policy.

Conventional notions of national accounting also attribute problems of domestic savings to domestic borrowing and capital account deficits. As such, economic measures to increase savings, despite of diminishing consumption, must be carried out in order to increase the pool of money available for investment.[79] The national construction of the economy, therefore, set the conditions to formulate and implement state policies that support 'progressive competitiveness' and 'punitive austerity.'[80]

Andreas Pickle argues that the most relevant context for the legitimation of the state is the nation because it appears as a static subject in a period of rapid economic change at the global scale.[81] The reproduction of the national scale of regulation relies on state policies that attempt to reposition and reproduce the 'national' economy within global accumulation at the expense of labour. This manifests itself in the state's preservation of currency worthiness, the maintenance of the national accounting system, and in policies of 'national competitiveness' and 'punitive austerity.' By looking at the

[78] Bryan, "Global Accumulation and Accounting for National Identity," p. 71.
[79] See: Organisation of Economic Cooperation, *Economic Surveys 1995 Member Countries: Mexico*, Paris: OECD, 1995.
[80] See: Greg Albo, "A World Market of Opportunities? Capitalist Obstacles and Left Economic Policy," *Socialist Register 1997: Ruthless Criticism of all that Exists,* London: Merlin Press, 1996.
[81] Andreas Pickel, "Explaining and Explaining with Economic Nationalism," *Nations and Nationalism,* 9: 1, 2003, p. 120.

construction of the nation-state as an 'imagined' economy, the financial system can be considered, not as the inevitable expression of the globality of accumulation, but rather as the result of the particular 'nationalising' state policies which both reproduce the national scale of the economy and internalise international norms of profitability.[82]

Competition, Economic Authoritarianism, and Political Scale

Regional, national, and local directions of rescaling do not exist independently. Different political scales reinforce one another and are highly interdependent. The downward rescaling of the state allows for the intensification of competition and, hence, the reiteration of an international norm of profitability. As such, the shifting of scale downwards complements the strategy of national competitiveness and upward scaling of state governance in several ways.

First, local scales of regulation intensify competition within the nation-state. Economically weak areas might attempt to emulate strong ones to attract investment.[83] This does not lead to uniform development among different localities and regions. Rather, the competition imperative among regions necessarily leads to the intensification of uneven development within the country.

Second, decentralisation becomes a process that serves to carry out the politics of territorial competition across local scales rather than an exclusive delegation of administrative responsibility. Local economic governance in this case exacerbates the

[82] Pickel, "Explaining and Explaining with Economic Nationalism," p. 121.
[83] Gough and Eisenschitz, "The Construction of Mainstream Local Economic Initiatives: Mobility, Socialisation and Class Relations," p. 192.

pre-existing tensions between and within localities, particularly around urban areas.[84] This takes the form of policies that compel localities to compete with each other for investment. This, in turn, fragments the forms of national economic governance to impose the market discipline more rigorously on workers and peasant communities, as well as the environment. As a result, the local scale becomes constituted as spatial fragmentation and as the space for greater competition to commodify labour and nature in accordance with global norms of profitability.

Third, the rescaling of the state upwards also opens territories to greater flows of capital and attempts to homogenise locations and organise them in terms of prices and costs. The regional construction of scale assists the state in the process of neoliberal restructuring by 'locking-in' state policies, thereby isolating them from social pressures and political change. In this way, international political scales naturalise economic and financial restructuring, preventing politisation of economic management at the local level. As such, regionalism depersonalises and depoliticises economic governance, hence replacing politics with discourses of a country's local and national competitiveness in relation to other 'regional trade partners.'

Fourth, central action at the national level is required to organise competition between localities and countries, organise flows, exchanges, collaboration, and competitions within the social formation and regionally. The nation, therefore, remains a pivotal representation of the spatiality of the state which simultaneously constitutes a

[84] Ian Deas and Kevin Ward "From the New Localism to the New Regionalism? Interpreting Regional Development Agencies," *Political Geography,* 19: 3, 2000, p. 287.

'collective experience' of the economy and implements the policies that assist in sustaining financial markets and accumulation in general.

The fragmentation of space through political scales is particularly relevant to financial markets. Financial markets have made production planning uncertain and risky. Different sites of production and exchange are located in different currency areas and are subject to changes in exchange rates, which rely on market conditions and state policies. At the same time, financial markets rely on production to realise profits. This realisation in turn requires conditions of certainty. The state's control over different spatial scales guarantees that territorial conditions of capitalist profitability are present across scales. The scale of state regulation can take the form of economic policies that sustain the national money worthiness and promote competitiveness in regions, cities, and localities.[85]

Conclusion

As a whole, the local, regional, and national politics of scale are not isolated or opposed forms of spatial organisation. Rather, they complement each other since these scales maintain the disciplinary effect of an international norm of profitability. While local economic governance contains class struggle and intensifies competition, the regional scale provides the conditions to secure this competition and 'lock-in' neoliberal policies. The nation-state, and more specifically, its representation and its policies, coordinates and enables competition among countries and localities.

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[85] Swyngedouw, "Globalisation or Glocalisation? Networks, Territories and Rescaling," p. 39.

Indeed, the transformations in the rescaling of the state produce changes in social relations. However, these changes do not occur as a mechanical response to shifts of state governance. Rather, different classes in the national social formation respond differently to scalar changes. As such, social classes in different places within the nation can, in various ways, adapt to or reject economic and social restructuring embedded in the rescaling process. The relationship between social classes within the nation-state to the process of global accumulation is, therefore, greatly shaped and influenced through the (re)production of political scales of state governance.

Chapter 7

Finance and the Rescaling of the Mexican State

The 'end of geography' thesis has been difficult to sustain. The lack of convergence of interest rates and purchasing power parities has shown the misleading assumptions of the 'borderless world' analysis. So has the emergence of regional blocs. The North American Free Trade Agreement (NAFTA) has incited an intense debate about the nature of the agreement and its impact on the Mexican economy. This debate has raised questions regarding the adequacy of the national organisation of the economy. It has caused many policy advocates in Mexico to urge for a territorial reconfiguration of the Mexican economy based on local and regional development. In this view, trade and investment flows, and skills and technological development are seen as the main causes for territorial reconfiguration in Mexico. These explanations, however, fail to account for the co-existence of the Mexican nation-state with other political scales and the social nature and constitution of political scales.

This chapter contends that the ability of capital to realise itself on a global scale is dependent on the creation of real production processes at national, regional and local scales, which are in themselves social processes mediated by the state. After the Mexican 1982 debt crisis, the Mexican state and the power bloc began to reorganise the Mexican economic space in order to attempt to resolve the contradictions of uneven development. This has been accomplished through the shifting of scales of governance upwards and downwards, and the reproduction of the national scale of the economy to attempt to guarantee the quality of money within its own territory, secure the production of the

means of debt repayment, and contain labour demands within the confines of the capitalist relations.

First, this chapter discusses the insights and limitations of the Mexican literature on NAFTA and local and regional development. Second, the chapter presents an overview of the different government programs that aim at reorganising social space within Mexico – NAFTA, political decentralisation and local development, and 'national competitiveness' policies. Third, I offer an interpretation of the reorganisation of the Mexican space in terms of their politics of scale – that is, the spatial expression of policies emanating from social groups with the purpose of locking-in policies, intensifying competition, and reproducing an 'imagined' national economy.

NAFTA, Local and Regional Development: The Mexican Perspective

The implementation of NAFTA brought about a controversial debate regarding the reasons for its creation and its impact on Mexican political economy. Three different theoretical discussions can be identified as the most significant explanations of the relationship between the Mexican economy and NAFTA. The economic rationalist approach has considered NAFTA as an opportunity for Mexico to access the American market. This debate has been greatly influenced by the Inter-American Development Bank's (IADB) views on regionalism. The IADB sees a shift from an 'old' to a 'new regionalism' in Latin America. According to the Bank, the 'old' regionalism was an economic policy that attempted to extend the ISI model to the regional level between 1950 and 1980. The goal of this strategy was to create a Latin American economic region with investment and trade barriers to other countries to stop competition from

industrialised countries.[1] The new regionalism, in contrast, is considered an important mechanism to reintegrate Latin American countries into the world economy, particularly after the debt crisis in the 1980s. This new regionalism consists of the joint-participation of a developing country with an industrialised economy in a trade agreement to promote open and competitive market-based economy, attract foreign investment, and have privileged access to industrialised countries' consumer markets.[2]

The participation of Mexico in NAFTA is then understood as increasing the benefits of the country's comparative advantages, since the agreement eliminates tariffs among the member countries, while permitting each member to set its own tariffs on imports from elsewhere.[3] NAFTA's legal framework is also seen as a mechanism to deal with the power asymmetries among member countries because of NAFTA's reciprocity rules, which provide conditions for regional convergence.[4] As such, NAFTA, according to this perspective, provides Mexico and Canada with certainty and transparency in trade negotiations against the unilateralism of the U.S.[5]

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[1] An example of 'old' regionalism was the 1950s' Latin American Free Trade Agreement, an initiative of Argentina, Brazil, Chile, and Uruguay, which incorporated Bolivia, Colombia, Mexico, Paraguay, Peru, and Venezuela as well. Robert Devlin and Antoni Estevandeordal, "What is New in the New Regionalism of the Americas?" *INTAL Working Paper,* 6, 2001, pp. 3-4.

[2] See: Inter-American Development Bank, *Beyond Borders: The New Regionalism in Latin America,* Washington, DC: Inter American Development Bank, 2002; Enrique Iglesias, "Global Positioning of the European Union and MERCOSUR: Towards a New Model of Interregional Cooperation," *Paper presented at the Annual Lecture at the Chaire Mercosur of the Institut d'Etudes Politiques de Paris,* Paris, 4 April 2002.

[3] Gustavo Venegas Cánovas, "La Política Comercial de México en el Sexenio 1994-2000: Crisis, Financiamiento y Recuperación Económica," *Foro Internacional,* 61: 4, 2001, p. 703; Nora Lustig, *Mexico, the Remaking of an Economy,* Washington: Brookings Institute, 1998, p. 138.

[4] Gustavo Venegas Cánovas, "La Política Comercial de México en el Sexenio 1994-2000," p. 703.

[5] See: Nora Lustig, "NAFTA, Potential Impact of Mexico's Economy and Beyond," in Roberto Bouzas and Jaime Ros (eds.), *Economic Integration in the Western Hemisphere,* Notre Dame: Notre Dame University Press, 1994.

Other analyses have noted that Mexico's convergence with its NAFTA trade partners has not been achieved despite the benefits of free trade. These analyses can be defined as the neo-Weberian view of NAFTA. This view considers that convergence has not been attained because of the lack of technological innovation and workers' skills, rigidities in Mexican labour markets, and the absence of regional institutions that can deal with economic and social asymmetries among NAFTA members.[6]

While the economic rationalist and the neo-Weberian approach differ in their emphasis on the region's convergence, they agree that an increase in foreign direct investment and trade liberalisation would be effective mechanisms for Mexico to catch up economically and technologically with its NAFTA neighbors. These approaches suggest that NAFTA and potential institutions at the regional level will bypass government corruption, open up markets, stimulate technological diffusion, and promote investment because of the increasing mobility of capital, labour, and technology.

The Marxist interpretation of NAFTA stresses the role of the United States in creating the regional framework, and, thus, the reinforcement of traditional patterns of

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[6] Daniel Lederman, William F. Maloney and Luis Serven, *Lesson from NAFTA for Latin America and the Caribbean Countries: A Summary of Research Findings*, Washington: World Bank, 2003, p. 27; Alfredo Guerra Borges, "Variaciones sobre el Futuro de la Regionalización," en Jorge Basave, et al. (eds.), *Globalización y Alternativas Incluyentes para el Siglo XXI,* Mexico: Porrua, 2002, p. 255; Ayhan Kose, Guy Meredith and Christopher Towe, "How Has NAFTA Affected the Mexican Economy? Review and Evidence," *IMF Working Paper*, 4: 59, 2004, p. 28; Gregorio Vidal, "Introducción, México en la Región de América del norte: Estancamiento y Profundización de la Desintegración Económica y la Desigualdad Social," en Gregorio Vidal (ed.), *México en la Región de América del Norte: Estancamiento y Profundización de la Desintegración Económica y la Desigualdad Social*, Mexico: Porrua, 2004, p. 22; José Luis Calva, "México: Alternativas dentro del Cambio Global," en Jorge Basave, et al. (eds.), *Globalización y Alternativas Incluyentes para el Siglo XXI*, México: Porrúa, 2002, p. 387; Teresa Gutierrez Haces, "Las Reglas de Origen como un Mecanismo de Exclusión en el Bloque Comercial de América del Norte," en Jorge Basave, et al. (eds.), *Globalización y Alternativas Incluyentes para el Siglo XXI*, Mexico: Porrúa, 2002, p. 476; Robert Pastor, *Toward a North American Community: Lessons from the Old Word for the New*, Washington, Institute for International Economics, 2000, pp. 99-117.

dependency. Juan Castaingts has argued that NAFTA was an American response to the trade challenges posed by the Association of East Asian Nations (ASEAN) and the European Union. As such, NAFTA is seen as a mechanism to reassert US power in the face of competition from other economic blocs.[7] John Saxe-Fernandez suggests that NAFTA is the "geo-strategic expression of U.S. interests."[8] Within this context, the Mexican state capacity to guide national economic policy is interpreted as declining since national policies are decided by the American state and US corporations.[9]

While many analyses of NAFTA focus on the specifics of the agreement and its national impact, other interpretations look toward local and regional forms of economic governance within Mexico as the most adequate organisation to deal with the challenges of North American regional integration. The economic rationalist view suggests that regional and local development is central to fostering particular competitive advantages of different localities in order to cope with the imperatives of NAFTA and globalisation.[10] Local and sub-regional strategies are seen as better suited to increase competitiveness because of these strategies' ability to account for the particular needs and capacities of a given locality. This perspective suggests that local private, public, and

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[7] Juan Castaingts Teillery, "El TLC como Resultado de un Mundo Triádico," *Problemas del Desarrollo*, 24: 95, 1993, p. 37.
[8] John Saxe-Fernández, "México: Globalización o Inserción Colonial?" *Problemas del Desarrollo*, 25: 96, 1994, p. 30.
[9] Saxe-Fernández, "México: Globalización o Inserción Colonial?" p. 31.
[10] World Bank, *Entering the 21st Century, World Development Report 2000*, Oxford: Oxford University Press, 2000, p. 32.

social sectors can now have greater participation in the formulation and implementation of policies at sub-national levels of governance.[11]

The neo-Weberian perspective considers that the changing conditions of the global economy and the imperatives of regional integration are the main causes for the shift from a national policy orientation of comparative advantage towards the creation of local 'competitive' advantages based on technology development and endogenous growth.[12] According to the OECD *2003 Territorial Review of Mexico*, endogenous growth can be achieved through the development of industrial clusters:

> The diffusion of clusters is implying a different micro-economic place-based foundation for economic development. Overall, the entry into force of NAFTA in 1994 has played a pivotal role in explaining the increased competitiveness of northern and central Mexico. These regions were enabled to further exploit their locational advantages conferred by proximity to the U.S. in order to attract FDI and increase exports.[13]

The OECD notes that the lack of regional convergence within Mexico is the result of Southern and Central Mexico's low level of education and skills of labour within this region.[14] The OECD has also suggested that regional disparities occur because small firms, which are oriented to domestic markets, have fewer incentives for organisational

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[11] Eduardo Iván Palavicini Corona, "Presentación de las nuevas estrategias para el desarrollo regional en la actualidad," *Gaceta de Economía*, 5: 10, 2000, p. 221.

[12] Rosalinda Arriaga and José Luis Estrada López, "Reestructuración del Comercio Exterior en México Durante los Años Noventa," *Análisis Económico,* 17: 36, 2002, p. 225. See also: Jaime Preciado Coronado, "Centro y regiones en México ante la gobernabilidad democrática local," *Gestión de las Transformaciones Sociales (MOST) Documentos de debate,* 58, 2002. Here, endogenous growth is described as the growth generated by investment in human capital, technological change based on "learning by doing" and "knowledge spillovers," and technological improvements arising from intentional innovation by producers in the local and regional context within a given country. See also: Ron Martin and Peter Sunley, "Slow Convergence? The New Endogenous Growth Theory and Regional Development," *Economic Geography,* 74: 3, 1998, p. 218.

[13] Organisation of Economic Cooperation and Development, *2003 Territorial Review of Mexico*, Paris: OECD, 2003, p. 85.

[14] Juan Navarrete, Juan, "Convergencia: Un Estudio para los Estados de la República Mexicana," *Documentos de Trabajo del CIDE*, 42, 1995, p. 10.

and technological innovation. As a result, these firms cannot create forward and backward linkages with other local economic industries and activities.[15]

Enrique Dussel Peters has also stated that local and regional development based on clusters remains weak in Mexico. According to Dussel Peters, local endogenous growth has been obstructed by policies of the Mexican state. He suggests that the limited focus of the state strategy on the promotion of exporting industries based on low labour costs only reproduces the polarising structure of the *maquiladora* industry and dampens innovation and development in the productive sector.[16] Dussel Peters indicates that Mexican suppliers have been unable to integrate into world markets due to insufficient financing by the state and commercial banks and the lack of state support for technological development.[17] Dussel Peters argues that export-oriented manufacturing, which hinges precariously on U.S. growth, cannot be expected to support future employment needs in a context where Mexico has suffered a dramatic loss of competitiveness against Asia and Central America.[18] He contends that competitive conditions for the productive sector need to be fostered along with regional integration of value-added chains, financing of enterprises, and training of labour.[19]

Indeed, a key aspect of globalisation has been the constitution of several regional blocs such as NAFTA. This trend towards regionalism has posed several challenges to

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[15] Organisation of Economic Cooperation and Development, *Territorial Reviews: Mexico*, p. 168.
[16] Enrique Dussel Peters, "Ser Maquila o No Ser Maquila, ¿Es esa la Pregunta?" *Comercio Exterior*, 53: 4, 2003, pp. 328-36.
[17] Enrique Dussel Peters, "El Tratado de Libre Comercio de Norteamérica y el Desempeño de la Economía en México," *Unidad de Comercio Internacional de la Sede Subregional de la CEPAL*, LC/MEX/L.431, Mexico, 2000, pp. 15-25.
[18] Enrique Dussel Peters, "México a 11 Años del TLCAN," *Latin Trade Network Papers*, 39, 2005, p. 26.
[19] Enrique Dussel Peters, "Cambio Estructural Regional, El Caso de Renania-Westfalia del Norte, Alemania," *El Mercado de Valores*, 2000, pp. 69-71.

understand why new forms of production, trade, and financial transactions are emerging in a regional context. The Mexican debate, however, remains limited in explaining power and class processes behind the construction of these scales, leading to a neutralisation of the power relations that are implicated in the processes of territorial restructuring in Mexico.

The economic rationalist position on NAFTA remains problematic. It removes any conception of exploitation from the process of profit making and asymmetries in the wage-labor relation within the regions of Mexico as well as at the national level. Neo-Weberian discussions of institutional and technological rigidities consider the nation-state as an obstacle to the well functioning of capitalism. Issues of inequality and the contradictory nature of capitalism are translated into institutional ineffectiveness. But the fact that technological and institutional arrangements are not neutral is the result of power relations, and these are left unexamined. In general, the rationalist and the neo-Weberian positions assume that multi-national regionalism is inevitable, and hence the emergence of a different spatial framework of accumulation is a natural evolutionary process that can remain unproblematised.

Contrary to these approaches, the Marxist debate accounts for aspects of political power behind the implementation of NAFTA, particularly that of the American state. Indeed, this approach is important to understand issues of U.S. imperialism and its relationship to Mexico. However, the role of the Mexican state and class relations within the country in shaping the outcomes of the agreement is often overlooked. By overemphasizing the role of the U.S. imperialism in constituting NAFTA, this view fails

to notice, as Leo Panitch and Sam Gindin state more generally, that American imperialism, "its complexity, its incompleteness, especially with regards to the Third World, depends on other states and hence the social formations and class struggles within them, and the weight given in its functioning to inherently volatile financial markets."[20]

Approaches to the territorial reorganisation of Mexico's regions and localities have provided the scope for discussing the slow rate of regional convergence within the country. Still, such views rely on misleading assumptions regarding convergence and technological spillover and human capital. On the one hand, the lack of regional convergence is seen as the result of the inability of the nation state to implement policies that maintain local competitiveness and allow the free flow of factors of labour and capital. On the other hand, the lack of regional development is seen as a technical matter which can be remedied by technological development and skill training. Both views, however, neutralise the power relations behind the reconfiguration of economies at the regional and local level. Also, these perspectives "treat firms as 'black-box' representative agents."[21] As a result, the fact that the free flow of capital and technological innovation are deeply embedded in organisational features and corporate systems based on competition is overlooked. Policies that move capital and labour across sub-national regions or improve skills and technology in a given region, moreover, might not prevent a firm from investing in locations that have the same factor endowments at lower costs. These perspectives, in turn, ignore the uneven geography that capitalism

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[20] Leo Panitch and Sam Gindin, "Finance and the American Empire," in Leo Panitch and Colin Leys (eds.), *Socialist Register 2005: The Empire Reloaded*, London: Merlin Press, 2004, pp. 73-4.

[21] Martin and Sunley, "Slow Convergence? The New Endogenous Growth Theory and Regional Development," p. 24.

produces. The power relations behind the spatial reorganisation of regions are not questioned. Instead, they are replaced with a view of internationalisation as an inevitable phenomenon to which localities have to adapt in order to develop.

These perspectives on NAFTA and local and regional development share a major shortcoming. First, they see state power as declining either because of the impact of regional trade agreements or as an obstacle to the creation of regional 'competitive' advantages that is being carried out to construct stronger market processes. These analyses beg the question of why the nation-state remains the central site where policies that foster the reproduction of capital at the international scale are located. They also fail to examine why and how the Mexican nation-state co-exists with other scales of economic governance, namely the region and the local. As a result, these debates do not look clearly at the reasons why – and the ways in which – accumulation is being reorganised at the regional and local level over the period of neoliberalism.

NAFTA, Mexican Finance, and Economic Restructuring

NAFTA went into effect in January of 1994, and was considered a key factor in the further development of Mexican capital markets. Still, NAFTA remained somewhat protective of the Mexican financial sector from foreign competition. The outcome of the negotiations related to the financial sector was set out in Chapter 14 of the agreement. This chapter includes the general framework agreed upon by the parties regarding the financial sector and the specific reservations to the agreement declared by each party in

the chapter's annexes.[22] NAFTA's regulatory measures on financial services (1403) comprises the terms and conditions under which financial institutions from one country can operate in another country (article 1404). Mexico's 26 exceptions are included in Annex B. The safeguards and regulatory measures (1403) assure that NAFTA members can preserve their own approaches to regulation and maintain autonomy with respect to stabilisation policies that impinge on the financial sector. This article declares that NAFTA parties are not restricted by the financial services part of the agreement from pursuing non-discriminatory measures of general application – this includes monetary policy, related credit policies, and exchange rate policies. The agreement, in theory, does not interfere with any the three countries' ability to carry out stabilisation policies in a non-discriminatory way.

Mexico's reservations restricted foreign investment in existing financial institutions.[23] Foreign banks within NAFTA could not own more than 30 percent of financial holding companies and commercial banks within Mexico. Likewise, foreign firms were banned from acquiring more than 30 percent of a Mexican security firm and more than 50 percent of a Mexican insurance company, a financial leasing company, or a financial factoring firm. The individual size of foreign financial affiliates was to be controlled by the ceilings imposed by the Mexican government on foreign investment. The aggregate capital limits for all financial sectors, other than insurance, were set at the initial levels for the first year of the agreement. These limits could be increased annually

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[22] *North American Free Trade Agreement,* NAFTA (signed and entered into force 1 January 1994), Chapter 14.
[23] Ibid., Chapter14, Annex B.

by equal increments to reach the final limit by the last year of the transition. As an additional safeguard to these transitional limits, Mexico retained the right to freeze – at any time during the first four years following the end of the transition period – the aggregate capital of foreign affiliates for commercial banks and securities at their current levels. This, however, could only take place if the aggregate of capital of foreign affiliates in these sectors exceeded 25 percent of the capital in banking or 30 percent in the securities industry.

NAFTA has also established a financial-services committee to supervise NAFTA's implementation, consider issues referred to it, and participate in dispute settlement. This committee meets once a year to assess the functioning of the financial services agreement. Finally, the agreement makes disputes in the financial sector subject to the dispute settlement procedures of Chapter 20. Disputes are referred to a NAFTA tribunal. If the complaint is upheld by the tribunal, the complaining party may suspend benefits in the financial services sector.

One year after the implementation of NAFTA, the Mexican economy was in a serious economic crisis. The Mexican peso had lost almost 50 percent of its value by December 1994. This put into question the advantages of NAFTA for Mexican capital markets. The crisis was followed by policies that seemed inconsistent with previous measures to protect the Mexican financial sector within NAFTA. This manifested itself in significant changes in the regulations governing foreign financial firms' entry into Mexico and resulted into a wave of mergers and acquisitions in the Mexican financial system. A revision to Mexican banking law, which came into effect February 16th, 1995,

reduced market share limitations on foreign banks. As a result, NAFTA banks – U.S. and Canadian – were allowed to expand their operations up to 25 percent of the total capital of all Mexican banks. Non-NAFTA banks could own up to six percent of the banking system.[24] Under these new rules, only the three largest Mexican banks – Banamex, Bancomer and Serfin – were off-limits.

These changes made entry by foreign institutions more likely. For example, General Electric Capital Corporation, a subsidiary of the General Electric Company, acquired a 13 percent of Grupo Financiero Serfin. Perhaps more significantly, Banco Bilbao Vizcaya (BBVA), a Spanish bank, became the first foreign financial institution to control a Mexican bank under these new regulations when it acquired 70 percent stake in Grupo Financiero Probursa in 1995.[25] In 1996, the Spanish Bank Bilbao Vizcaya acquired other small banks and Bank of Montreal purchased 16 per cent of Bancomer. Eventually, the Spanish bank Banco Santander acquired most of Serfin, the third largest bank in Mexico, and other minor banks, and Citibank bought Banca Confia. Yet, several limits on investment by foreign firms in the Mexican banking sector continued during this period.

The legislation that contained further acquisitions and mergers in the Mexican financial system was, however, reversed in 1998. Ceilings on foreign investment were removed, allowing foreign companies an unlimited access to the financial sector in

[24] Sima Montamen-Samadian, "Economic Integration, Capital Flows and Financial Instability," Christos C. Paraskevopoulos, et al. (eds.), *Global Financial Markets and Economic Development*, Toronto: APF Press, 2000, p. 42.
[25] Barbara Belejack, "The Nafta Syndrome," *World Business,* 2: 3; 1996, p. 16.

Mexico. The new banking legislation gave way to two of the most controversial mergers in Mexico: the Bancomer-Bilbao Vizcaya and Citigroup-Banamex.[26]

By the year 2000, Grupo Financiero Bancomer SA had a 1.2 billion dollar agreement to merge with Spanish bank Banco Bilbao Vizcaya Argentaria (BBVA).[27] In 2001, Citigroup agreed to buy Grupo Financiero Banamex-Accival SA for 12.5 billion dollars in cash and stock. According to the Central Bank, that same year the Mexican economy received an unprecedented capital inflow of foreign direct investment of 24 billion dollars. About half of this amount corresponded to the acquisition of Banamex by Citigroup.[28] This deal was the end of a series of foreign acquisitions in Mexico since the entry of NAFTA in 1994.[29] After the merger operation with Banamex, Robert Rubin, as chairman of Citigroup's executive committee, concluded that "the vision of NAFTA –

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[26] Vanesa Beltrán and Veronica Reynold, "Llegan Banqueros a Mérida con Instituciones Sólidas, pero con Capital Foráneo," *El Economista*, 15 July 2003.
[27] In the middle of these negotiations, Banamex made an unsolicited bid for 65 percent of Bancomer. This latter bid challenged the preliminary agreement in which BBVA would take over 30 percent of Bancomer and management control. This resulted in a conflict between Banamex and the Spanish bank. Banamex argued that some of the clauses appeared damaging to Bancomer's shareholders. Roberto Hernández, head of Banamex, undertook a campaign against the acquisition of the major Mexican financial institutions by foreign companies. Banamex, in turn, was attacked by Carlos Slim, owner of the privatised phone company, Telmex, on the grounds that Banamex received substantial government backing since the 1994 peso crisis. This struggle expressed itself within the state. This merger proposal of Banamex faced anti-trust conditions. This dispute over Bancomer concluded with this bank's controlling shareholders' approval of BBVA's offer over the unsolicited bid by Banamex. Joel Millman and Keith Johnson, "Mexican Banks Emerge as Hot Merger Plays," *Wall Street Journal*, 5 May 2000.
[28] Roberto González Amador, "Representa 19.53% respecto al año pasado, dice la SE," *Jornada*, 25 May 2000.
[29] In the year 2002, there was the least controversial purchase of a Mexican bank by a foreign firm. HSBC Holdings, the world's second-largest banking group, agreed to buy Grupo Financiero Bital. With 1,400 branches and six million customers, Bital is Mexico's fifth-largest retail bank. The acquisition was in line with the HSBC's strategy to increase its presence in North America. Paul Day and Charles Pretzlik, "HSBC moves into Mexico with $1.14bn Bital Buy," *Financial Times*, 22 August 2002.

the vision of these two countries being inextricably linked together economically – is a vision that is now well advanced."[30]

Regional Development and Political Decentralisation in Mexico

Following the crisis, the Mexican state also responded to financial distress and broad political challenges by devoting increased attention to economic and political developments at the local level. Previous to the crisis, the centralisation of political power reached its maximum expression between 1988 and 1994, particularly through the National Solidarity Program (Programa Nacional de Solidaridad, or PRONASOL). This eventually became the Secretary of Social Development (Secretaría de Desarrollo Social, or SEDESO), targeting the urban poor, peasant smallholders, and indigenous communities. As the antipoverty ministry, SEDESO served multiple political ends. One of those objectives was to build support for the Executive and official party (PRI) in low-income communities where traditional corporatist structures had begun disintegrating, reducing the Executive's dependence on the traditional party hierarchy.[31]

The crisis of 1994, along with divisions within the PRI, the combination of the triumph of the opposition at the state and municipal elections and social discontent opened the way to an accelerated process of political decentralisation. The potential for political change rapidly shifted to the regions within the country.[32] This involved greater attention being directed to economic and political developments occurring at the state and

[30] Paul Beckett and David Luhnow, "Citigroup Agrees to Buy Mexico's Banacci," *Wall Street Journal*, 18 May 2001.
[31] Eliza Willis, Christopher and Garman, Stephan Haggard, "The Politics of Decentralisation in Latin America," *Latin American Research Review*, 34: 1, 1999, p. 8.
[32] The first objective was achieved through an amendment to Article 115 of the constitution. It included expansion of the responsibilities of the municipalities and increased rights over property taxes and fees.

municipal levels. Federal agencies became more decentralised from 1995 onwards. Revenue-sharing and transfers to lower levels of government increased.[33] Due to demands from the opposition parties for more autonomy and financial resources to states and municipalities, the Ernesto Zedillo Administration (1994-2000) created Section 33 in the federal budget. This section establishes a direct transfer of financial resources to local governments that do not need to be employed in a program or a particular public service specified by the federal government.[34] Also, a network of regional centres for competitiveness was created in order to replicate the experience of Mexico's northern economies elsewhere within the country during this administration.[35] As such, the fostering of national competitiveness through the creation of economic advantages at local and regional levels became one of the main policy objectives of the Mexican state.

During the Vicente Fox Administration (2000-06), this tendency towards decentralisation and local development continued. This administration created the Agency of Urban Development and Territorial Ordering (Desarrollo Urbano y Ordenamiento Territorial) within SEDESO. This agency elaborated a national program of urban development which emphasised the importance of the synergy between the region and the city. The importance of this program, the agency notes, derives from the centrality of the region and the urban localities to maximise the economic efficiency of

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[33] For instance, two-thirds of the funds formally administered under PRONASOL, including all investments in physical infrastructure, were transferred directly to states and municipalities in 1996. Responsibility for the implementation of such programs shifted from SEDESO federal delegates to municipal governments. See: Robert Kauffman and Guillermo Trejo, "Regionalism, Regime Transformation and PRONASOL: the Politics of the National Solidarity Programme in Four Mexican States," *Journal of Latin American Studies*, 29: 3, 1997.

[34] Here, Municipal Councils of Development (Comites de Planeación del Desarrollo Social, or COPLADES) are in charge of channeling these resources to the municipalities.

[35] Anonymous, "Mexico's New Frontier," *The Economist*, 8 February 1997, p. 41; Rosa Elvira Vargas, "Insta Zedillo a no Impugnar Derrotas Electorales ni enterrar al Vencido," *La Jornada*, 18 March 1997.

the sub-national territory and harmonise local and regional growth with national economic competitiveness.[36] For this reason, the National Development Plan 2001-06 identified several meso-regions in the country, which are units of planning for regional development. Each unit comprises several states that are integrated into a meso-region in order to coordinate economic and development projects.[37]

In the Entrepreneurial Development Program 2001–2006, the Fox government also recognised that competitiveness is a factor that Mexican firms could use to increase a region's capacities and become pillars of income and employment in the country. According to this program, which was carried out by the Ministry of Economy, the lack of competitiveness occurs because regions and localities have not been able to consolidate their economic potential because of an inefficient public sector, inadequate enterprises, the lack of competitive infrastructure, and, most importantly, low productivity.[38] The Mexican Chamber of Deputies under the Fox Administration also created the Special Commission for Competitiveness and Regional Development in order to coordinate efforts in this matter with the federal and the state governments. The state governors have also acted locally to attract further investment and have demanded from the federal government a better redistribution of resources to the states in order to encourage local, regional, and national competitiveness.[39]

Along these lines, several regional projects were undertaken at the federal and state level. Former Mexican President Vicente Fox stressed the importance of two

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[36] Alicia Ziccardi, "La Planeación Urbana Municipal," en Enrique Cabrero Mendoza (ed.), *Políticas Públicas Municipales. Una Agenda en Construcción*, Mexico: CIDE, 2003, pp. 144-6.
[37] Presidencia de la República, *Plan Nacional de Desarrollo 2001-2006*, Mexico, 2001, p. 10.
[38] Secretaria de Economia, *Programa Nacional Empresarial de Competitividad,* Mexico, 2001.
[39] Olaf Carrera, "Thinking Nationally, Acting Locally," *Business Mexico*, 14: 5, 2004, p. 43.

particular regional projects – the *Plan Puebla Panama* (PPP) and the *Cuenca de Burgos* (Burgos Basin).[40] The PPP is the culmination of previous attempts to "modernise" southern Mexico. This includes the expansion of industrialisation and infrastructural projects, particularly highways. The region, as it is often argued, provides several business opportunities because of its ecological diversity, the abundance of its natural resources, and its relatively inexpensive labour. The Plan Puebla Panama aims at remedying poverty problems in Southern Mexico, particularly in rural communities, by providing low wage employment and privatising the communities' environmental surroundings.[41]

The *Cuenca de Burgos* is a project that includes the Northern states of Tamaulipas, Coahuila and Nuevo León, and Texas. This regional plan is based on the exploitation of natural gas at the regional level, while incorporating this area into the larger North American energy market.[42] This gas basin is divided in 10 *bloques* or sections around which gas exploitation is organised. Also, gas production in each section is not being undertaken directly by PEMEX, but rather by private companies through government contracts. The companies involved in the exploitation of natural gas are Repsol, Tecpetrol, Industrial Perforadora de Campeche, Lewis Energy Group, Petrobrás, and Teikoku y Diavaz.[43] The purpose of this project is to develop industries related to

[40] Presidencia de la República, "Consolidar los proyectos de meso-regiones, indispensables para la competitividad mundial," *Press Release Sistema de Internet de la Presidencia*, Mexico, 11 April 2005.
[41] See: Hepzibah Muñoz Martínez, "State, Capital and 'Second Nature': Re-Territorialisation in the Plan Puebla Panama," *Capitalism Nature Socialism*, 15: 1, 2004.
[42] See: North American Energy Working Group, *North American Natural Gas Vision*, January 2005.
[43] See: Secretaria de Energía, *Prospectiva del Mercado de Gas Natural 2006-2015*, Mexico, 2006.

the energy sector and create employment around this industry (skilled labour with low wages) in order to "strengthen northeast Mexico's regional development."[44]

The promotion of industrial clusters is also considered a desirable strategy to foster regional development.[45] Particular importance is placed on the auto industry clusters that already exist in the country. This is considered a strategic sector in the economy since it represents 16 percent of the GDP in the manufacturing sector, 21 percent of its exports and 18 percent of sector's employment.[46] Three major regional clusters in the automobile industry are identified: North, Centre, and Bajío.[47] The Mexican government aims at replicating this experience in the high tech sector, and for that reason it has implemented several programs such as the Program for the Development of the Software Industry (PROSOFT) and the Support Program for the Development of New Enterprises Based on Scientific and Technological Advances (AVANCE). PROSOFT was an initiative implemented during the Fox administration to finance and support enterprises in this sector.[48] AVANCE is the continuation of this policy in Felipe Calderón's administration (2006-12).[49]

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[44] See: Petróleos Mexicanos, "Se reune Muñoz Leos con los gobernadores de Coahuila, Nuevo León y Tamaulipas," *Boletín de Prensa PEMEX*, 17 May 2004; Estado de Nuevo León, "Programa para Integración del Desarrollo Regional del Noreste y su Vinculación con Texas," *Periódico Oficial del Estado*, 5 March 2004; Presidencia de la República, *Programa de Desarrollo Regional Frontera Norte 2001-2006,* Mexico, 2002.
[45] See: Secretaria de Economia, *Acciones Concretas para Fortalecer el Desarrollo Económico*, Mexico: 2004; Secretaría de Economía, *Programa para la Competitividad de la Industria Electrónica y Alta Tecnología,* Mexico, 2001; Secretaría de Economía, *Mexico Economic Outlook and Investment Opportunities*, Mexico, 2006.
[46] Secretaría de Economía, *Mexico Economic Outlook and Investment Opportunities*, p. 6.
[47] Ibid., p. 16.
[48] Secretaría de Economía, *Programa para la Competitividad de la Industria Electrónica y Alta Tecnología,* p. 140.
[49] Secretaría de Economía, *Mexico Economic Outlook and Investment Opportunities*, p. 4.

Competitiveness in the Mexican National Economy

Despite the new government focus on NAFTA and regional and local development, the Mexican balance-of-payment remains the main indicator of the Mexican economy's performance for banks, policy-makers, investment-rating agencies, and international organisations. This indicator is composed of four main categories. The current account indicates economic transactions, in goods and services, between Mexican nationals or firms and the rest of the world. It is worth noting that dollar transfers from Mexican immigrants, particularly from the U.S., are considered a special category within the current account. The capital account, on the other hand, records changes in liabilities and assets between Mexican individuals or companies and the rest of the world. The other two components are the federal reserves of the central bank and errors and omissions. The current and capital accounts are the main guides of economic policy since the decrease or increase of federal reserves are considered to be the result of the current and capital accounts movements. Also, both accounts are the underlying justification for policies that promote the national competitiveness agenda.[50]

The Mexican balance-of-payments position became central in explaining the peso crisis of 1994. The crisis was seen as the result of deficits arising in the current and capital accounts that depleted foreign exchange reserves. Following the debt crisis, the current account became one of the main targets of Mexican economic policy. By 2002, the Mexican state identified several problems with the export-oriented sector's

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[50] See Banco de México, *Comunicado de Prensa La Balanza de Pagos en 2004,* Mexico, 22 February 2005; Secretaría de Hacienda y Crédito Público, *Comunicado de Prensa Información Oportuna Sobre la Balanza Comercial de México Durante Marzo 2005,* Mexico, 22 April 2005.

competitiveness, particularly the *maquiladoras,* due to competition from China, the lack of technological improvement, and the absence of an efficient industrial organisation.[51] Ernesto Derbez, former Minister of Economy and Foreign Affairs Minister during Fox's period, argued that the lack of competitiveness of Mexican exports jeopardised improvements in the current account deficit, employment rates, and the economy in general.[52] The governor of BANXICO also noted that it is not sufficient to add technology and skills to productive sectors in order to improve Mexico's balance of payments. He argued that it is necessary to undertake reforms in labour legislation (further flexibilisation of labour) and in the taxation system (taxes on food and medicines, for instance), and to carry out the privatisation of Mexico's energy sector to decrease the current account deficit and increase the competitiveness of the Mexican economy.[53]

NAFTA and the Upward Scale of the State

An approach to the politics of scale of the Mexican state allows for an understanding of the coextensive presence of regionalisation, national and local economic restructuring. This view considers that capitalism relies on the continuous transformation of the temporal and spatial horizons of its operation.[54] The Mexican state has been able to shift the scale of governance upwards through the negotiation of a regional agreement in North America. This has entailed a re-configuration of political scales through which the state has the ability to shape particular social relations that extend over the region.

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[51] David Zúñiga, "Las maquiladoras no generarán ni inversión ni empleo este año," *La Jornada*, 24 January 2003.
[52] Miriam Posada García, "Insta Derbez a Impulsar la Competitividad," *La Jornada*, 9 December 2002.
[53] Israel Rodríguez, "Discrepan Ortiz y Gil Díaz sobre Crecimiento Económico," *La Jornada*, 8 April 2003.
[54] Eric Swyngedouw, "Globalisation or Glocalisation? Networks, Territories and Rescaling," *Cambridge Review of International Affairs*, 17: 1, p. 32.

This has also manifested itself by various connections such as highways and telecommunications, value flows and commodity movements, the embodiment of values in various fixed facilities like towns, factories and, most importantly, state regulations contained within NAFTA. This regional structured coherence has accelerated the circulation of capital. In this way, NAFTA has become a strategy in which the state, along with the power bloc, attempt to "annihilate space through time" without actually dissolving space but rather by reorganising regulatory scales.

This is expressed in Chapter 14 of NAFTA which guarantees national treatment to all financial services from the NAFTA countries. While some exceptions are made for the adoption of 'prudential' measures that are non-discriminatory, these measures still aim at protecting the interests of capital. For instance, state intervention is considered necessary to protect investors, depositors, financial market participants, policy holders, and policy claimants. This is both to maintain the safety and soundness of financial institutions and cross-border financial service providers and to ensure the stability of the financial system. As a result, these regulations ensure that Mexican monetary policy not only aims at guaranteeing capital's profitability within its own nation-state but also across North America.

Other state obligations to capital are guaranteed throughout the agreement, particularly in Chapter 11 and 20. In many respects, Chapter 20 and Chapter 11 are alike. A central difference, however, is that under Chapter 20, only a government may initiate proceedings to address a breach in the agreement, while under Chapter 11, non-governmental entities may initiate a dispute resolution. Due to the measures that

facilitate the "investor-to-state: dispute within NAFTA, it would be more likely that breaches in the agreement will be disputed through Chapter 11 rather than Chapter 14.[55]

This is particularly problematic since Chapter 11 includes several ambiguous clauses which tribunals have often used in favour of corporations. NAFTA's Article 1110 guarantees compensation to foreign investors from NAFTA governments for any direct government expropriation or any other action that is 'tantamount' to an indirect expropriation. This clause, however, remains vague and often does not refer to the government seizure of property, which is the meaning generally conveyed by the term. Rather, this clause has been interpreted in a broad way by NAFTA tribunals. NAFTA has, under Chapter 11, made it acceptable to define expropriation of investor's property as any domestic legislation that might be seen as 'discriminatory.'[56]

The Mexican state, along with the Canadian and the American states, has established that the so-called investor-to-state cases are litigated in special arbitration bodies of the World Bank and the United Nations. These bodies are closed to public participation. A panel composed of three arbitrators decides the amount of the award that the country in breach of NAFTA has to pay. In many cases, the tribunals dealing with the dispute mechanism have avoided creating a precedent that would allow the NAFTA countries to solve conflicts with corporations in domestic courts. This, in turn, points to the political practices that reproduce the regional scale of governance and decision-

[55] Chapter 11 empowers private investors and corporations to sue NAFTA-signatory governments in special tribunals to obtain compensation for government policies or actions that investors believe violate their new rights under NAFTA. This, in turn, allows the corporation to avoid the country's domestic court system and domestic laws to obtain such an award.
[56] Public Citizen, *NAFTA Chapter 11 Investor-to-State Cases: Bankrupting Democracy*, Washington DC, 2001, p. 13.

making within North America. As a whole, this investment chapter establishes an array of new investor rights and privileges, including restrictions on countries' policies to counter currency speculation such as regulation of financial transfers.

The process of shifting the scale of governance upwards through NAFTA has, in turn, served as a 'conditioning' framework through which neoliberal policies have been 'locked-in' in Mexico. This conditioning framework became the institutional mechanism through which the power bloc has manipulated international obligations such as economic liberalisation to impose policies that "would not otherwise meet with general support."[57] The shifting of governance through NAFTA has also isolated the power bloc from societal pressures that oppose, for instance, investor rights within the agreement. This political insulation and 'locking-in' of neoliberal policies indicate that the stipulations of NAFTA were not imposed upon the Mexican state by the American capital and the American state alone. As Leo Panitch argues, the role adopted by the Mexican state can be explained in terms of the interests and bureaucracies that it represented.[58]

As such, the Mexican state has assisted and guided the process of shifting scales of decision-making upwards through NAFTA. NAFTA has, therefore, reinforced the notion of shifting political scale and decision-making processes as politically and socially neutral.[59] In other words, this shift of governance upwards has tended to depersonalise

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[57] Ricardo Grinspun and Robert Kreklewich, "Consolidating Reforms: Free Trade as a Conditioning Framework," *Studies in Political Economy*, 43, 1994, p. 36.

[58] Leo Panitch, "Globalisation and the State," in Ralph Miliband and Leo Panitch, (eds.), *Socialist Register 1994: Between Globalism and Nationalism*, London: Merlin Press, 1994, p. 52.

[59] Jaime Gough, "Changing Scale as Changing Class relations: Variety and Contradiction in the Politics of Scale," *Political Geography*, 23: 2, 2004, p. 199.

political process and decision-making since regulations and compensation to foreign firms are seen as the result of 'technical' procedures within the dispute settlement mechanism in NAFTA.

NAFTA not only represents a mechanism to change decision-making mechanisms, but it also is the expression of state scalar strategies to reconfigure space to facilitate accumulation and foster capital territorialisation within the region in a context of global competition. This is expressed in the NAFTA Secretariat Declaration of 2004, in which the regional body states that "NAFTA offers a solid competitive advantage to our countries in a globalised world."[60] The intervention of the state to homogenise space within the differentiated region of North America is particularly specified in the Security and Prosperity Partnership of North America Agenda (SPP) of 2005.

This agenda indicates the need to increase the region's productivity through the lowering of production costs for North American businesses and ensuring compatible regulations among NAFTA members to increase trade and investment. Particular attention is given to the strengthening of North America's energy markets within this agenda. The SPP Declaration indicates that integration of energy markets can only occur through changes within national legal frameworks and investment in energy infrastructure and technology improvements. Likewise, the document emphasises the need for infrastructural investment to improve North America's transportation system to encourage trade and investment. In addition, the partnership also expresses the

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[60] Comisión de Libre Comercio de América del Norte, *Declaración Conjunta Una Década de Logros*, San Antonio, 16 July 2000.

commitment of the NAFTA counties "to work towards the freer flow of capital and the efficient provision of financial services throughout North America."[61]

The spatial restructuring of the North America region involves the strong participation of private corporations, excluding citizens from this process. This is evident in the SPP initiative of the North American Competitiveness Council (NACC). The NACC is made up of 10 private members from the business community who meet annually with the SPP Ministers to provide recommendations and priorities on promoting the competitiveness North American firms globally.[62] This process of spatial restructuring is then shaped by the state in close cooperation with the private sector. This is expressed in the statement by U.S. Commerce Secretary Carlos Gutierrez during the launching of the NACC: "The private sector is the driving force behind innovation and growth, and the private sector's involvement in the SPP is key to enhancing North America's competitive position in global markets."[63]

The rescaling of state governance, however, is not a one-dimensional and unchallenged process. On the contrary, the process of politics of scale and state rescaling is highly contested. It implicates social struggle around the command over scales. This manifested itself in the conflict within the Mexican power bloc that prevailed over the NAFTA negotiations on the Mexican financial sector. On the one hand, there was a strong interest on the part of the Salinas Administration in NAFTA's success. In order to achieve this goal, the dominant sectors of the Mexican power bloc considered it

[61] Alianza para la Seguridad y la Prosperidad de América del Norte, *Declaración Trilateral Agenda para la Prosperidad*, Waco, 23 March 2005.
[62] Secretaria de Economia, Dirección General de Comunicación Social, *Mexico, Estados Unidos y Canadá Instalan Consejo de Competitividad de América del Norte,* Washington, 15 June 2006.
[63] Ibid.

necessary to grant concessions to North American capital and the American and Canadian state. This included the 'national treatment' privileges to Canadian and American banks stipulated in Chapter 14. On the other hand, other sectors within the power bloc believed that protection of Mexican financial sector was necessary to allow the newly privatised banks – and their owners – to obtain their share profits from the Mexican market.[64] Consequently, the newly privatised banks were willing to accept a gradual phase-in of their entry positions and certain market-share restrictions.[65] For instance, the four largest banks remained protected by a restriction that prevents foreign banks from obtaining more than six percent of the Mexican market when acquiring a Mexican bank.

It is often argued that NAFTA led to the end of restrictions on foreign financial services. Concerns about leaving the Mexican financial sector in the hands of foreigners were raised among different social sectors within Mexico, particularly from the left. It was argued that the possession of Mexican banks by foreigners would harm Mexican society since the activities of foreign corporations were detached from productive sectors of the Mexican economy that provide employment.[66] The financial policy within Mexico that restricted foreign access to this sector was not reversed through the first half of 1995. The gradual opening of the financial sector in the second half of 1995, therefore, has more to do with the leverage of the power bloc rather than with external impositions of

[64] For an insightful discussion of NAFTA negotiations, see: Maxwell Cameron and Brian W. Tomlin, *The Making of NAFTA, How the Deal was Done*, Ithaca: Cornell University Press, 2000.
[65] Stephan Haggard and Sylvia Maxfield, "Financial Internationalisation in the Developing World," in Benjamin Cohen and Charles Lipson (eds.), *Issues and Agents in International Political Economy*, Cambridge: MIT Press, 1999, p. 272.
[66] Carlos Heredia Zubieta, "Banamex-Citigroup: El fin de la Banca Mexicana," *La Otra Cara de México*, July-August, 2001, p. 2.

foreign capital. The amalgamation of foreign and Mexican banks served as a social strategy for the Mexican internal bourgeoisie. While the power bloc, linked to the Mexican financial sector, has not disconnected itself from the fortunes of its enterprises in Mexico, its merger operations have served to insulate themselves from domestic political pressures and economic restructuring within Mexico. Consequently, this bourgeoisie has a stake in the entrance of foreign financial firms into the Mexican economy, since this meets the internal class interests of the Mexican power bloc. Again, this shows that the process of shifting economic organisation of capital upwards works to depersonalise lending and investment decisions, which are often attributed to 'market forces.' In this way, mergers and acquisitions make the Mexican financial sector less subject to domestic political pressures. Yet, the conditions for mergers and acquisitions in the financial sector continue to be set by the Mexican state.

On the one hand, a critical analysis of NAFTA shows how the state has been integral in the construction of this regional scale. Within this condition framework, the state has been able to guarantee the continuity of neoliberal policies and the insulation of economic decision-making from popular demands. On the other hand, Mexico's reservations in Chapter 14 of NAFTA confirm the importance of class struggle, particularly the power bloc, in the construction of 'region.' When the protection of Mexican banks against foreign competition was no longer necessary, domestic legislation was changed to open the Mexican banking system to foreign investment. In the same manner, the interests of the power bloc have been integrated into the SPP through NACC.

Investment of this financially-oriented sector has been secured through the policies of NAFTA and the prospects of 'structured coherence' within the SPP.

Decentralisation and Regional Development in Mexico: Shifting Political Scales Downwards

Two of the central features of the Mexican government in recent years have been regional and local development and decentralisation. This policy agenda often refers to cooperative local initiatives and political partnership between different levels of government resulting from restructuring after the 1994 peso crisis and new forms of economic linkages. Also, the government's initiatives to foster local and regional development are based on the assumption that Mexico is a country where there are serious regional economic disparities. Several federal governmental agencies, international organisations, and state governments have pointed out that these economic and social disparities need to be solved through policies that promote clusters and increase technological and skill capacities in order to promote high productivity and competitiveness at the local level. This, it is argued, would eventually close the gap between export-oriented and domestic market-oriented sectors of the economy, assist localities to specialise in an economic activity, and solve regional disparities.[67]

This proposal of regional and local development presupposes that development within the country can be relatively equalised. This is due to the lack of understanding of a particular territorial contradiction between the processes of territorialisation and deterritorialisation of capital. In this respect, Jaime Ornelas Delgado notes that there are new regions of capitalist concentration within Mexico:

[67] Organisation of Economic Cooperation and Development, *2003 Territorial Review of Mexico*, p. 82.

> These new regions offer new advantages over the traditional spaces such as Mexico, Guadalajara, and Monterrey. Their need to 'economically develop' makes these new regions offer more advantages to private investment. In this way, labour conditions become flexible and the state provides infrastructure and urban services at low cost with the purpose of attracting the necessary investment that help 'modernise' the productive structure of those regions.[68]

This is particularly reflected in the reorganisation of space through the Plan Puebla Panama and the *Cuenca de Burgos* regional projects. The economic organisation of Northern Mexico around the *maquiladoras* has gradually become an obstacle for capital accumulation due to devaluation of fixed capital, rising wages, and increased union mobilisation.[69] For this reason, *maquiladoras* have begun moving to Central and Southern Mexico, attracted by the lower wages and the advantages that the Mexican state provides to capital through the Plan Puebla Panama.[70]

The Mexican state has sought to mediate – and temporarily solve – the struggle over wages and markets caused by capital deterritorialisation in the North through the implementation of a regional project based on the exploitation of natural gas. This has become an attempt to reterritorialise capital within this region and to link this part of the country to a larger North American energy market. The Mexican state is also seeking to emulate the existing organisation around automobile clusters in Northern Mexico in order to create new areas of economic activity such as the high tech sector. In general, both

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[68] Jaime Ornelas Delgado, "Neoliberalismo y Ocupación del Territorio en México," *Problemas del Desarrollo,* 25: 99, 1995, p. 66.
[69] See Cirila Quintero, "Globalización y Estrategias Sindicales en la Maquila. Interacción Entre lo Global y lo Local," *Memoria Una Mirada de las Relaciones Internacionales desde lo Local,* San Luis Potosí, 2004, p. 32.
[70] David Zúñiga, "Las Maquiladoras no Generarán ni Inversión ni Empleo este Año", *La Jornada,* 24 January 2003.

regional development projects are complementary to the upward shift of the scale of the Mexican state to sustain profitability within Mexico and across North America.[71]

The process of differentiation in the context of territorialisation and deterritorialisation is further intensifying competition between localities since economically strong areas in northern Mexico seek to maintain or increase their differentiation from the weak localities. Competition at the sub-national level within the Mexican economic space creates more differences, since regions and localities are offering more favourable investment conditions, such as infrastructure and tax incentives, than their counterparts to attract investment. As Daniel Hiernaux notes, the Mexican state has abandoned the idea of solving regional disparities to embrace a regional policy that "promotes the existence of differential and competitive conditions among the diverse regions that constitute the political-administrative nation-state."[72]

The promotion of regional development through clusters has become a disciplinary mechanism. Examples of regional restructuring are the clusters in the automobile sector in Cd. Juárez Chihuahua. These clusters are composed of an automaker and several subsidiaries and outsourcing companies that collaborate in the car assembly industry.[73] Outsourcing in Mexico is characterised by lower wages and benefits than in assembly industries. It is likely that an entire factory or section is closed down temporarily to cut production costs in this form of industrial organisation. If

[71] See: Secretaria de Desarrollo Social and Colegio de Arquitectos de la Ciudad de Mexico, *Mexico 2020: Un Enfoque Territorial de Desarrollo,* Mexico, 2000.
[72] Daniel Heraux, "En la Búsqueda de un Nuevo Paradigma Regional," en Blanca Ramírez (ed.), *Nuevas Tendencias en el Análisis Regional*, Mexico: UAM, 1991, p. 43.
[73] Through outsourcing, automakers concentrate on the aspects of the value chain that provide the most profitability while leaving other stages of production to components firms.

workers are laid off, they receive neither wages nor social benefits attached to full-time employment.[74] In these clusters, individual contracts have replaced collective bargaining. This has resulted in a shift from the regulation of capital-labour relations within the state to the workplace. As such, conflicts in the workplace are solved internally by the company's managers with low union intervention in most of the cases. In this context, the employer's intervention often results in a decision favorable to the company and detrimental to workers. Individual contracts have also replaced collective benefits with a bonus that is calculated according to each workers' productivity level.[75] The local organisation of firms around clusters promoted by the state is disciplining labour even more because of the flexibilisation of production.

It is worth noting that the construction of regional development does not follow a specific logic of capital. Rather, it is influenced by the balance of forces within the country. In the case of the PPP, the current power of the internal bourgeoisie has allowed this class to participate in the design and implementation of this regional scale because of their interests in obtaining contracts to build highways and invest in the tourism, energy, and biotechnology sectors.[76] The Burgos Basin project has also responded to changes in the power structures at the state and federal level. The Burgos Basin project has been welcomed by both the federal and the state governments. This is due to the fact that PRI state governors in this part of the country have been limited in their access to federal

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[74] Scout B. Martin, "Global Sourcing Dynamics, Inequality, and 'Decent Work in Auto Parts': Mexico Through the Brazilian Looking Glass," *International Affairs Working Paper,* 2006-08, 2006, p. 30.
[75] Maria Eugenia de la O, "Ciudad Juarez: Un Polo de Crecimiento Maquilador," en Maria Eugenia de la O y Cirila Quintero (eds.), *Globalización, Trabajo y Maquilas*, Mexico: Plaza y Valdes, 2002, pp. 54-5, 66-7.
[76] Andrés Barreda Marín, "Los peligros del Plan Puebla Panamá," en Armandro Bartra *Mesoamérica, los ríos Profundos: Alternativas plebeyas al Plan Puebla Panamá,* Mexico: Instituto Maya, 2001, pp.136-56.

resources due to the PAN's victory in the presidential elections of 2000. Thus, the state governments of Nuevo Leon, Tamaulipas, and Coahuila see the *Cuenca de Burgos* as an untapped source of wealth to reproduce the power position of their elites within their jurisdictions.

The projects of regional development have also been accompanied by proposals and programs of decentralisation, particularly of state and municipal taxation and spending. This process has been partly fostered by the rupture between the Executive and the state governors which started in the Zedillo Administration and has continued with Fox's and Calderón's presidencies. Traditionally, the partnership between municipalities, state governors, and the Executive was secured through the mechanisms of clientelism within the PRI, as levels of government were controlled by the PRI. During Zedillo's period, the rupture between these levels of government was due to the victory of the PAN in some municipal and state elections. Later on, the PAN's triumph in the presidential elections of 2000 made it more difficult for municipal presidents and state governors, particularly from the PRI, to access public resources for personal appropriation and to reproduce their power position within their states and municipalities.

For this reason, several state governors from the PRI organised themselves into the National Conference of Governors (Conferencia Nacional de Gobernadores, or CONAGO) in 2002. Through this mechanism, the state governors have demanded increases in federal transfers to support regional development programs, and legislative changes that would allow states and municipality to impose taxes.[77] At the same time,

[77] See: Fernando Pérez Correa, "Hacia la Convención Nacional Hacendaria," *Este País*, 155, 2004.

regional and local development projects have served to mediate and negotiate political struggle within the power bloc, particularly between the federal government of the PAN and the PRI-based state and municipalities. The construction of the 'local' and the 'regional' as economic scales of governance have been the result of the struggle within the ruling bloc over spatial scales of regulation. At the same time, state governments and their local elites are now able to influence the urban and regional organisation of the economy through regional projects. While the creation of local institutions and decentralisation is defended on the basis of enhancing democratic control, the Mexican case suggests a tendency toward a loss of democratic control and an institutional basis that functions through a very small elite basis. The reorganisation of space through regional and local development and decentralisation has then shifted the agenda from the traditional revolutionary national discourse of redistribution towards one of regional and local growth and opportunity.[78]

The insertion of regional development and decentralisation into the political agenda in Mexico shows the interplay of two contradictions within the geography of capitalism. The equalising tendencies of the market expressed in every locale's compliance with an international criterion of profitability co-exist with differentiating forms of the scalar organisation of space. The Mexican nation-state still remains critical in mediating these contradictions and organising space within the social formation to set the conditions that ensure the reproduction of relations of domination. While the fragmentation of space is carried out by the Mexican state through the decentralisation

[78] Erik Swyngedouw, "Reconstructing Citizenship, the Re-scaling of the State and the New Authoritarianism: Closing Belgian Mines," *Urban Studies*, 33: 8, 1996, p. 153.

and regional development agenda, the state also hierarchises places on the basis of power relations through NAFTA, corporate amalgamation in the financial sector, and the reproduction of the national scale of the economy. The latter takes the form of policies of national competitiveness that impose the burden of economic restructuring on labour.

National Competitiveness and Mexico's 'Imagined Economy'

The depiction of the Mexican economy as an economic unit is created and recreated through power relations to constitute the idea of 'economic nationality.' This, in turn, produces the idea of an 'imagined' community that shares the same economic experience across the country. This generalised economic shared experience is reflected in the policies that emerge from balance-of-payments accounts.

The Mexican balance-of-payments has become the main data source to evaluate the economy. The debt crisis of 1982 positioned balance-of-payments as a fundamental economic category to both measure the economic performance and upon which to base economic policies. According to the De la Madrid Administration, and other international organisations, the government expanded debt-financed spending in the late 1970s and a highly overvalued peso, diminished exports, and aggravated balance of payments problems.[79] Consequently, the policies that followed the 1982 crisis centred their attention on the equilibrium of the balance-of-payments as a mechanism to diminish inflation and increase exports. Subsequent to this period, this method of national accounting has become pivotal in informing policy-makers and corporations with regards

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[79] See: Nora Ampudia Márquez, "Treinta Años de Política Monetaria en México," en Etelberto Ortiz Cruz (ed.), *Hacia Una Política Monetaria y Financiera para el Cambio Estructural y el Crecimiento*, Mexico: UAM-Plaza y Valdes, 2003.

to a nation's productivity and competitiveness – how productive a nation must be and what sectors should be politically and economically supported to make the 'national' economy more competitive.

Still, this depiction of the Mexican national economy as an economic unit remains problematic. Balance-of payments do not adequately record international movements. Also, the Mexican balance-of-payments might not register money activities that are unrelated to the current account such as transactions in money markets. In many instances, financial operations are categorised in national accounting as foreign direct investment or national savings ('good' money), when, in fact, this 'investment' or 'saving' is financial speculation and a potential loss.

Also, assumptions of national coherence of economic performance remain misleading. Balance-of-payments construct an image where interactions among individual capitals are considered as relations between nations, turning different kinds of portfolio investment transactions into a "shared national experience of the international economy" that does not necessarily exist.[80]

This is the case of foreign debt which is portrayed as a 'shared national experience' when, in fact, foreign debt is not a national liability (not all Mexicans invested in financial markets or borrowed dollars from abroad), even though the contrary was the prevalent approach used to manage the peso crisis of 1994. Also, the policies to use public funds to rescue the Mexican banks after the 1994 crisis reproduced a national construction of debt. The National Commission of Banking and Securities argued that by

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[80] Dick Bryan, *The Chase Across the Globe: International Accumulation and the Contradictions for Nation-State*, Boulder: Westview Press, 1995, p. 126.

transforming these loans into public debt, these loans could be repaid "in the best terms possible with the lowest interest rates, [while the lack of recognition] of these debts would have implied denying reality and passing off the burden to future generations of Mexicans."[81] In this way, the Central Bank, as well as other agencies of the Executive branch, by attributing a national meaning to the liquidity crisis of the Mexican banking system, continues to create and reproduce the national scale of the economy and turn it into an objective and neutral 'national' economic interest. Balance-of-payments, therefore, give a national significance to debt figures even if the debt problem comes from capital financial flows of private firms. National savings remains an illusion, since capital's ability to move does not make permanent national savings feasible. Still, this gives a sense that by following policies to correct the lack of national savings and the increase of 'national' debt, national gains will be attained.[82]

Notions of national competitiveness also reproduce methodological nationalism – that is, the measurement of the macro-economic unit of analysis of the nation state with a micro-economic criteria of the firm's and the household's performance. For instance, former president Ernesto Zedillo stated that "[he] believe[s] that countries must be austere just like families ... The country must grow modestly with its own resources rather than with money borrowed abroad."[83] Assumptions of 'national competitiveness,' as formed in the policy discourse of the Ministry of the Economy, portrays the lack of

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[81] Comisión Nacional de Bolsas de Valores, *Todo lo que usted queria saber sobre el Fobaproa,* Mexico: 10 November, 1998, p. 3.

[82] Dick Bryan, "Global Accumulation and Accounting for National Identity," *Review of Radical Political Economics*, 33: 1, 2001, p. 71.

[83] Craig Torres and Dianne Solis, "Zedillo pide Paciencia para aplicar su Plan de Austeridad en Mexico," *El Norte*, 12 August, 1996.

national economic growth in Mexico as the result of the inability of workers to adapt to lower wages and more flexible forms of organisation as well as the inefficient forms of state intervention. The Ministry has indicated that China's labour costs are lower than in Mexico in the electronics manufacturing industry.[84] In general, the Ministry considers that Mexico has lost competitiveness because of rising labour costs without a relative increase in productivity.[85] For this reason, the government advocates a labour policy that links wages to productivity, promotes investment in technology and labour skills, and encourages new forms of business organisation such as outsourcing.[86]

This is reflected in the government programs such as AVANCE and reforms to labour regulations. Changes to Mexican labour law, which are often referred to as the Abascal Law, were implemented by former Minister of Labour, Abascal Carranza, under the Fox Administration. This law increases job insecurity since it introduces new types of labour contracts, such as seasonal, training and indefinite-period contracts. Under these categories, workers can be fired without justification and can be hired for short periods of time without benefits.[87] In case a worker is not satisfied with her labour conditions and wages or wants to be part of a union, the worker can lose its job easily without consequences for the employer. The rationale behind these reforms, therefore, is to ensure collaboration between capital and labour, diminish unionisation rates and maintain low wages. These reforms have guided the disciplinary effect of local economic governance that promotes high levels of productivity with low wages.

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[84] Secretaria de Economia, *Acciones Concretas para Fortalecer el Desarrollo Económico*, p. 23.
[85] Ibid., p 63.
[86] Ibid., p. 65.
[87] See: Adrían Sotelo Valencia, "La reforma laboral: la Ley Abascal," *Revista Trabajadores,* 37, pp.39-45.

Such policies reflect a 'national' construction of competitiveness and austerity. It describes the national economy as a shared economic experience of the gains and losses of globalisation among equal individuals within the country and whose activities are judged internationally. This particular construction of the nation shows how spatial power of the nation-state has two main effects. First, this image of the 'Mexican economy' nationalises the conditions for economic and social development so that the reorganisation of class relations to restore profitability takes place within a national horizon. Second, it establishes the basis for national politics to define the general interest and mobilise "the people-nation" behind national interest.[88]

Money, Power Bloc, and Neoliberalism in Mexico's Politics of Scale

The constitution of different scales of economic governance shows how the reorganisation of the Mexican space is central to the politics of money. First, the wider regional scale of NAFTA guarantees and protects private investment in a larger geographical extension. Second, the constant depiction of the economy as a national experience further disguises the power relations behind Mexican monetary policy. Through the continuous reconstitution of the national scale of the economy, the prevention of inflation through the 'short' and inflation targeting is not seen as a policy that rewards private firms, particularly financially-oriented companies, but rather as a necessary mechanism for the economic well-being of the Mexican population. Third, the intersection of regional, national and local scales produces an intensification of competition and the acceleration of the pace of accumulation. This, in turn, guarantees

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[88] Neil Brenner, et al., "Introduction: State/Space in Question," in Neil Brenner, et al. (eds.) *State/Space: A Reader*, Oxford: Blackwell Publishers, 2003, p. 10.

the realisation of profits within the Mexican economic space, which allows for the further international reproduction of capitalist social relations.

The changing scales of governance of the Mexican state also show how class politics and the mediation of class conflict by the state are expressed spatially. On the one hand, the financial sector of the power bloc was able to include their demands within NAFTA. This shaped the nature of this regional agreement. Likewise, NAFTA 'locked-in' the policies necessary to protect the investment and guarantee the profits of the Mexican power bloc across the North American region. On the other hand, the local scales of economic governance have mediated and expressed the capitalist class conflict over the command of the Mexican economy, particularly of those non-hegemonic sectors within the power bloc. As mentioned, struggle within the power bloc intensified and became more clearly expressed in a territorial form, particularly after the triumph of the PAN in the presidential elections of 2000. By reorganising the Mexican national economy into sub-regions and descentralising the federal budget, PRI-based elites were able to exert some control over local economies. This prevented further confrontations with the federal government. At the same time, regional development projects allowed the less-financially oriented sectors of the power bloc to increase their profits through flexibilisation of labour conditions at the local level and their participation in the design, planning, and implementation of regional development projects.

The construction and implementation of market discipline by the Mexican state has not only been expressed politically but also spatially. Neoliberal restructuring has taken place through the transformation and reproduction of the political scales of

NAFTA, national balance-of-payments and the local reorganisation of the economy through clusters, the PPP, and the Burgos Basin project. These political scales of the 'regional,' the 'national' and the 'local' have brought about geographical hierarchies of power relations. The interplay of these political scales has further integrated the Mexican economy to the process of internationalisation while intensifying the pace of accumulation within the nation-state.

Conclusion

As a whole, the Mexican literature on NAFTA and Mexican regional and local development see the reproduction of the national and subnational forms of economic and social organisation as territorial containers that oppose and/or respond passively to external stimulus from the global economy and NAFTA. As Blanca Ramírez argues, this dichotomises the spatial process of capitalism since "the local seems to be the only scale where passive social agency takes place while globalisation appears to be an agentless and ineluctable process."[89] This not only conceals and marginalises the intense and ongoing sociospatial struggles in Mexico, but also overlooks the ways in which the state employs spatial strategies, namely the production and reproduction of political scales, to organise capitalism and mediate class struggle within Mexico.

Not only are political scales constituted politically and socially, but also the (re)constitution of political scales can transform social relations. The socialised representation of firms' interaction, into a national category and a national experience,

[89] Blanca Ramírez Velázquez, "Globalización o Escalas en el Análisis Territorial: El Inicio de un Debate," en Elsa Patiño Tovar and Jaime Castillo Palma (eds.), *Globalización y Reestructuración Territorial,* Puebla: Programa Editorial de la Red de Investigación Urbana, 1999, p. 60.

does have policy implications, since it is through policy-making that states reproduce the national scale. In order to reconcile different interests of capital and the contradictory relationship between the national space state regulation and the global scope of accumulation, policy-making in Mexico has focused on 'national competitiveness' linked to local productivity and NAFTA's imperatives of restructuring. Here, the national space has made labour the main target of economic policy. As such, the burden of economic adjustment is imposed on Mexican labour through a focus on national competitiveness, local productivity, and regional adjustment. Labour, therefore, pays for the costs of the intensification of contradictions in the capital accumulation, in particular those expressed in the financial sector.

Part 4 Financial Innovations and the Mexican State

Chapter 8

Derivatives and the Discipline of Capitalism

After the 1994 peso crisis, the role of finance in influencing economic, political, and social outcomes has become even more powerful in shaping Mexico's contemporary political economy. Despite its significance in the economy, finance continues to be assumed by most analysts of Mexican monetary developments as a risk-management tool or as speculation external to accumulation. It is necessary, however, to consider the specific form that financial investment takes in order to understand the different ways the territoriality of the Mexican state has formed the Mexican economy *via* global finance over the past 15 years. It is the territoriality of the state that shapes finance, including the modern modalities of money and not finance that determines the spatial and functional dimensions of the state. It is, therefore, necessary to focus on the emergence of the derivatives market and its relation to finance over the period of neoliberalism.

A discussion of the nationality and territoriality of international accumulation and finance presents several complexities. It remains difficult to relate territoriality to financial derivatives, particularly since the collapse of the Bretton Woods system in the early 1970s. In its aftermath, currencies have been increasingly issued outside the territories from which they normally originate and whose value they represent. This has made it difficult to locate the internationalisation of capitalism within a spatial dimension, since derivatives facilitate the hedging of risks across currencies and thus across space. The rise of financial derivatives has transformed accumulation and the role of money in this process. International financial derivatives, however, do not entail the

end of geography and do not eliminate national distinctions. Derivative markets are driven by the territorial differences produced by the nation-state. Indeed, derivatives bridge the geographical differences comprised in interest and currency rates.

First, the chapter presents an overview of several debates on finance, including their contributions and shortcomings in the analysis of global financial markets. Second, a brief explanation of different derivative instruments is offered. Third, I draw from Dick Bryan's and Michael Rafferty's work on derivatives and capitalism to show how these instruments have facilitated the internationalisation of capital and altered the nature of money, competition, and ownership. Fourth, the role of derivatives in disciplining social relations, particularly labour, is examined. Fifth, the importance of the nation-state in reproducing derivative markets is discussed.

The Theoretical Debate on Finance

The internationalisation of capital has often been associated with the predominance of finance in the process of globalisation. While debates of the relationship between internationalisation and finance have been previously addressed, it is necessary to understand the particular conceptualisations of finance and financial crisis in each of the theoretical approaches. Economic rationalist conceptions of money and finance attempt to describe it in terms of its functions, namely as a unit of account, a common measure of value, medium of exchange, means of payment, and a store of value.[1] Milton Freidman and Anna Schwartz go on to suggest that "money is that to which we choose to assign a number by specified operation; it is not something in

[1] Glyn Davies, *A History of Money from Ancient Times to the Present Day,* Cardiff: University of Wales Press, 2002, p. 27.

existence to be discovered like the American Continent; it is a tentative financial construct to be invented like length, or temperature or force in physics."[2] Here, money is portrayed as a neutral mental construction that facilitates exchanges in the "real economy."[3] Within this perspective, the financial system is, therefore, a mechanism to funnel money and its purchasing power from "surplus spending units to deficit spending units."[4] Financial assets such as derivatives are seen as instruments to manage business, currency, and interest rate risks in the process of money circulation through different economic units.[5] According to the economic rationalist approach, the combination of risk management instruments and demand and supply of money in the financial system lead to a self-regulating and stable global economic system, provided that agents have access to information that reveals the economy's vulnerability to crisis. As such, crises do not result from the inherent dynamics of the financial system itself. Rather, they originate from conditions of partial information and constraints on economic actors set by the state.[6]

The neo-Weberian position considers that finance is at the centre of informational capitalism. Castells argues that accumulation and "value-making is generated increasingly in global financial markets enacted by informational networks in the

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[2] Milton Friedman and Anna Schwartz, *Monetary Statistics of United States: Estimates, Sources, Methods*, New York: National Bureau of Economic Research, 1970, p. 137.
[3] Joseph Schumpeter, *A History of Economic Analysis*, London: Routledge, 1994, p. 227.
[4] David Kidwell, et al., *Financial Institutions, Markets and Money*, Princeton: John Wiley and Sons, 2003, p. 5.
[5] Glen Arnold, *The Handbook of Corporate Finance*, Glasgow: Prentice Hall, 2005, p. 115.
[6] See: David DeRosa, *In Defense of Free Capital Markets: The Case Against a New International Financial Architecture*, Princeton: Bloomberg Press, 2001.

timeless space of financial flows."[7] The neo-Weberian framework also considers finance as a fundamental node in the 'spaces of flows.'[8] Castells identifies financial centres as nodes because they create new knowledge and value within a network of information flows.[9] Castells also identifies Saskia Sassen's triad of global cities – London-New York-Tokyo – as the pinnacle of the global financial hierarchy.[10] These nodes accumulate and retain wealth and power not because of what they produce, but because of what flows through them. Sassen has argued that these financial centres or global cities localise knowledge and financial control complexes.[11] Despite the localisation of finance in concrete financial centres, mobility of capital between these financial centres prevails. Sassen adds that the flows are leading to a "denationalization of domains once understood and/or constructed as national."[12] Financial crises that take place in these nodes are seen as the inevitable result of the volatile dynamics of informational capitalism.[13] For this reason, this view advocates state policies that promote symmetry of information and a supervisory framework to manage financial volatility.[14]

The Marxist understanding of finance has placed particular attention on the speculative character of finance and its negative effects over production. It is argued that contemporary capitalism has led to the hegemony of finance over industry. For instance, William I. Robinson argues that "in the 1970s and 1980s, finance capital came to

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[7] Manuel Castells, *The Rise of the Network Society,* Oxford: Blackwell Publishers, 1996, p. 379.
[8] A node is a structure built at the recurrent intersection of different flows of information that connect networks to each other. Castells, *The Rise of the Network Society,* p. 470.
[9] Ibid., p. 415.
[10] Castells, *The Rise of the Network Society*, p. 379.
[11] See: Saskia Sassen, *Cities in a World Economy*, London: Pinge Forge Press, 2000.
[12] Saskia Sassen, "Spatialities and Temporalities of the Global: Elements for a Theorization," *Public Culture,* 12, 2000, p. 216.
[13] Castells, *The Rise of the Network Society,* p. 135.
[14] Ibid., p. 162.

determine circuits of global accumulation. Money capital, rather than investment capital, became the regulator of global circuits of production."[15] The hegemony of finance and the decoupling of finance from industry are the result of the end of the long cycle after the post-war economic boom. This phase was characterised by large capital savings and accumulated surplus, which led to the transference of capital "in increasing quantities from trade and production to financial intermediation and speculation."[16] In this view, the negative effect of financial speculation over production produces instability in the capitalist system. Rapid movements of financial capital that is not invested productively undermine the production process.[17] Capital flight occurs when capital moves, monetary claims exceed the realisation of profits in production, and labour rebels against capital.[18]

The economic rationalist position ascribes money and finance with neutral properties in the process of exchange and production. Derivatives, for instance, are seen as instruments to manage risk and secure the value of money across national currencies and time. Also, financial crises are seen as the result of state constraints on finance. Such a conception, however, overlooks the social and power relations behind financial capital and its role in creating crisis and ignores the role of nation-state in constituting financial markets.

The neo-Weberian approach depicts finance as a fundamental node in the 'network society' that decides over the value-making process. Still, the origin and the

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[15] William I. Robinson, *A Theory of Global Capitalism: Production, Class and State in a Transnational World,* Baltimore: John Hopkins University Press, 2004, p. 51.
[16] See: Giovanni Arrighi, *The Long Twentieth Century,* London: Verso, 1994, p. 215.
[17] James Petras and Henry Veltmeyer, *System in Crisis,* New York: Palgrave, 2003, pp. 9, 11; Michael Cox, "The Search for Relevance: Historical Materialism after the Cold War," in Mark Rupert (ed.) *Historical Materialism and Globalization*, New York: Routledge, 2002, p. 67.
[18] John Holloway, "Capital Moves", *Capital & Class*, 57, 1995, p. 144.

conceptualisation of finance are limited to a technological explanation. In other words, the predominance and the substance of financial markets are technological innovations and profits that come from high tech sectors. Attempts to conceptualise concrete space of global finance through nodes or global cities fail to recognise that the prevalence those financial centres is the result of the power and policies of their territorial nation-states. The contagious effects of financial crisis and the state policies to contain them are explained in terms of technological and state adaptation to global markets, which conceals the political and social power behind finance.

In contrast, the Marxist approach position regards speculation and the predominance of finance as having an influence on accumulation, particularly on production. The Marxist reliance on Keynesian notions of speculative finance and its automatic opposition to financial capital prevents this perspective from further analysing the workings of financial instruments. Werner Bonefeld argues that "the critique of speculation has to be a critique of the capitalist form of social reproduction. Without such a critique of capital, the critique of speculation is reactionary."[19] This critique, however, remains limited to whether or not the state can control finance in order to sustain production, and the technical inner workings of finance are left unexamined. The role of currency and interest rates in financial markets, for instance, is seen as the given price of money. As such, the role of exchange rates and interest rates in maintaining and changing the value of capital as it crosses currencies is not problematised.

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[19] Werner Bonefeld, "Globalisation: Crisis of Regulation or Crisis of Capital?" *Globalización,* 2002. http://rcci.net/globalizacion/2002/fg255.htm, retrieved 8 August 2007.

The economic rationalist approach to finance, on the one hand, does engage with a technical understanding of financial innovation, particularly derivatives. There has been a burgeoning literature on risk management and financial derivatives.[20] The formalistic and instrumental study of these instruments, however, takes the emergence of derivatives for granted, and therefore does not allow an understanding of the social significance of financial derivatives in accumulation. On the other hand, the neo-Weberian and the Marxist position address the destabilising character of finance and its effects on production. Still, the lack of explanation of the technicalities of finance, particularly derivatives, prevents these approaches from further analysing the ways in which financial innovation has transformed international accumulation. "But the technical dimensions of derivatives do matter," Dick Bryan and Michael Rafferty note.[21] An understanding of the mechanics of financial derivatives is, therefore, necessary in order to understand how financial innovation has transformed global accumulation.

Derivatives and Global Accumulation

Derivatives have become one of the most dynamic financial markets. By the second half of 2005, the notional amount of all types of over-the-counter (OTC) contracts, excluding credit derivatives, was $285 trillion dollars.[22] The increasing importance of derivatives has been shaped by price volatility and floating exchange

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[20] See, for instance: Mark A. Trombley, *Accounting for Derivatives and Hedging*, Boston: McGraw-Hill, 2003; John Martin, *Applied Math for Derivatives: a Non-quant Guide to the Valuation and Modeling of Financial Derivatives,* New York: Wiley, 2001; Kevin Dowd, *Beyond Value at Risk: The New Science of Risk Management*, New York: Wiley, 1998.

[21] Dick Bryan and Michael Rafferty, *Capitalism with Derivatives: A Political Economy of Financial Derivatives, Capital and Class*, London: Palgrave, 2006, p. 21.

[22] Bank for International Settlements, *OTC Derivatives Market Activity in the Second Half of 2005*, Basel, 2006, p. 1.

regimes that followed the collapse of the Bretton Woods system.[23] Floating exchange rates have provided more flexibility to price relations. At the same time, price instability and the internationalisation of trade and investment have made it necessary for companies to use derivatives in order to sell and buy assets continuously in different national moneys and interest rates and hedge its exposure to interest and currency changes.[24]

Derivatives are often described in economics as a two-party financial contract, the worth of which is derived from the value of some underlying asset (a currency, security or commodity), reference interest rate (a rate based on the prime), or index (Standard and Poors Index). They can be futures, options, and swaps contracts and can be traded in specific market places or by private arrangement called OTC transactions.[25]

A simple derivative could be an interest rate swap. In this swap, two companies might borrow in different currencies or in different interest rate systems. Companies borrow where they are able to maintain the greatest share of profits, and acquire swap repayment obligations with other companies in order to obtain other gains in various currencies and interest rates. For instance, a Mexican firm issues 10 million dollars' worth of bonds with five years maturity with a fixed coupon of five percent. This firm needs to pay the fixed rate on its bonds and wants to take advantage of low floating interest rates. For this reason, the firms might seek a quote paying floating rate in pesos rather than a fixed interest rate. In this way, the Mexican firm enters into a swap with an

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[23] The Bretton Woods system of international monetary management established the rules for commercial and financial relations which included the obligation for each country to adopt a monetary policy that maintained the exchange rate of its currency within a fixed value – plus or minus one percent – in terms of gold. It also gave the IMF the mandate (and some capacity) to bridge temporary imbalances of payments.
[24] Bryan and Rafferty, *Capitalism with Derivatives*, pp. 12, 50.
[25] Thomas McInish, *Capital Markets*, Massachusetts: Blackwell, 2000, p. 304.

investment bank, where it pays a floating interest rate and receives fixed interest rates in order to pay the bonds issued by the company.[26]

Another example is a currency option, which is used when a firm wants to hedge the risk of exchange rate fluctuations. A firm might pay a fee to a financial institution for the future right to buy Mexican pesos, for example, at the current price. If the price of the peso depreciates, the firm does not have to exercise the option. But the advantages of doing so are obvious if the reverse is true: the option buyer therefore obtains more pesos with fewer dollars.[27]

In this market, participants can buy and sell without having to put down a significant amount of cash as a collateral payment. With financial derivatives, money can be invested in future prices by putting down a small portion of the value of the item. This results in the leverage of the dealer. This means that the dealer is able to pay only a small amount of money, but have assets worth more money than the collateral.

The examples of swaps and options described here put into question the conventional notion of derivatives. Bryan and Rafferty note that the common wisdom on derivatives is misleading because it confines its explanations to physical commodities and present derivatives as a mere reflection of price movements in real assets. As such, this interpretation tends to overlook the rise in derivative transactions in assets other than

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[26] McInish, *Capital Markets*, p. 304.

[27] Randall Dodd, "Derivatives, the Shape of International Capital Flows and the Virtues of Prudential Regulation," *World Institute for Development Economics Research Discussion Paper No. 2002/93,* Washington, 2002, pp. 8-10.

physical commodities, such as interest and exchange rates, and the ways in which derivatives are actually determining asset prices.[28]

Bryan and Rafferty indicate that an alternative understanding of the social meaning of derivatives can be grasped when considering the blending and fragmenting attributes of these instruments. For instance, in the case of swaps, different forms of assets – currencies and interest rates – are blended into a single commodity. This results in the amalgamation of different exchange and interest rates into a single market.[29] Also, the use of derivatives allows for the fragmentation of one particular asset into several of its attributes. These attributes can be universally tradeable without exchanging the actual underlying asset. In this way, assets do not enter markets as commodities, firms or national moneys, but as price relations that can be packaged and traded as commodities.[30] It is also worth noting that these markets are not available to everyone. They are designed for large banks and corporations which not only want to hedge risk but also obtain great profits (and at times losses) out of these transactions.[31]

Derivatives have transformed the way in which firms and financial markets operate. While it is argued that derivatives diminish exposure of firms to changes in prices, these instruments do not eliminate risk. Rather, they transfer and diversify risk. As a result, investors – companies, banks national governments – can use these financial instruments to explore a wider range of activities that can help them to be financially flexible, obtain investment yields, and borrow at lower costs. These activities are no

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[28] Bryan and Rafferty, *Capitalism with Derivative*, p. 11.
[29] Ibid., p. 49.
[30] Ibid., p. 52.
[31] See: Frank Partnoy, *Fiasco: The Inside History of a Wall Street Trader,* New York: Penguin Books, 1999.

longer confined to a given national capital market. Instead, a company can sell the firm's stocks in any number of international markets and a government can issue government bonds in its own national currency or any other worldwide *via* the derivatives market.[32]

Undoubtedly, derivatives do involve speculation, which makes these markets volatile. But one cannot dismiss them as just speculation or as the expression of technological innovation. Rather, other questions arise about the nature of money and capital accumulation when one considers that most of the trading in these instruments occurs without the physical possession or exchange of the underlying asset.[33] While derivatives are instruments through which companies attempt to reduce risk, the process of doing so also changes the role of money and the nature of ownership and competition in the process of accumulation.[34] As a result, it is important to understand how derivative markets relate to accumulation, the state, production, and labour.

Derivatives, Money, and Continuity in the Circuit of Capital

Marx's views of money provide several insights into understanding the role of derivatives in accumulation, particularly his notion of exchange value in the circuit of social capital. Marx argues that commodity production necessitates the transformation of quality – that is, the particular labour process and its product into quantity. The latter occurs when the socially necessary labour embedded in a commodity is measured against money. This entails the same quantitative measurement of distinct labour processes

[32] Michael Pryke and John Allen, "Monetized Time-Space: Derivatives-Money's New Imaginary?" *Economy and Society*, 29: 2, 2000, p. 268.
[33] Ibid., p. 272.
[34] Bryan and Rafferty, *Capitalism with Derivatives*, p. 23.

occurring at different moments in the circuit of social capital.[35] Money guarantees that value is preserved in the process of accumulation. Money is also central in the international expansion of capital, since the crossing of individual capitals and the relocation of production can only occur through money.

Rafferty and Bryan argue that the circuit of total social capital portrays conceptually the process through which value is preserved. In other words, value is preserved through the exchange of money for commodities which are placed in the process of production. Production, in turn, preserves or increases the value of money that entered into the circuit. Yet, exchanges that allow the different crossings of capital do not occur in the same exchange process and at the same discount rate. On the contrary, the international expansion of capital as a social relation takes place in different contexts, different spatialities, and at different times. Commodities produced in different countries with the same amount of labour time can have unequal values expressed in prices.[36] The spatial differences of these processes are expressed in the existence of different currencies. Under these circumstances, value is not secured at each point of the circuit since the exchange is done with different exchange rates and interest rates. As such, different spatial and temporal particularities intervene in the measuring of value against money. For this reason, it is difficult to verify the equivalence between moneys and

[35] Karl Marx, *Capital Volume II*, New York: Penguin Books, pp. 427-8.
[36] Michael Rafferty and Dick Bryan, "Financial Derivatives and Value Theory: Towards a Theory of Capitalist Money," *University of Western Sidney, School of Economics and Finance Working Paper Series, Paper No. 2003/07*, 2003, pp. 9-10.

commodities, and hence the commensuration necessary for the international crossing of capitals described by Palloix is not guaranteed.[37]

The fixed exchange rate system comprised in the Bretton Woods system reconciled differences of space and time between one commodity and another through the fixed exchange rate system. With the breakdown of the Bretton Woods system, there has been a rupture between money and the exchange standard. Under conditions where there is not a single currency or a commodity to measure value, the problem arises of how money and commodities can be measured against each other if their exchange occurs in different currencies.[38]

Rafferty and Bryan argue that derivatives have, in fact, provided the means of commensuration necessary to guarantee value in the circuit of capital across exchange and interest rates.[39] Capitalists do not want to lose the worthiness of their assets in different currencies, and they use derivatives to cover the risks of exchange rate and interest rate movements. In other words, derivatives help spread the risk of holding a particular asset in a given currency.[40] Financial derivatives are, in fact, better suited for globally integrated accumulation in the context of floating exchange rates. Derivatives have become a universal system of equivalence that is self-perpetuating, since derivatives are able to hedge one another.[41] Derivatives help bridge the non-equivalence of value in production and exchange denominated in different moneys by setting an expected rate of

[37] Rafferty and Bryan, "Financial Derivatives and Value Theory," p. 10.
[38] Ibid.
[39] Ibid., pp. 10-4.
[40] Ibid., p. 10.
[41] Neil Ackland, et al., "Financial Derivatives and Marxist Value Theory," *School of Economics and Political Science, Working Papers*, 2000, p. 8.

conversion of one form of commodity or money into another.[42] As a result, derivatives hedge against discontinuities that emerge from the different temporalities and spatialities of production, circulation, and reproduction of capital.

By allowing the commensuration of different localities and temporalities, derivatives have provided global accumulation with conditions of flexibility and continuity.[43] Derivatives turn a commodity into money without the actual physical exchange, and simultaneously transform money into tradable commodity. For instance, an automobile company can turn cars that have not yet been produced or commercialised into liquid money through an equity swap. Corn that has not been cultivated or harvested becomes money into a *future*.[44] Likewise, the peso or the baht, which are currencies that measure value nationally, can be packaged into a derivative and transformed into commodity which is sold and bought through a currency swap. One form of capital, such as the production process of corn, can be measured against a portion of the production process of a car. One form of money, the peso, can be evaluated against the baht. In this way, a fragment of capital can be measured against another fragment. This maintains continuity in the process of international accumulation. As such, circulation and realisation of surplus value in the same currency does not have to take place for the circuit to remain uninterrupted.

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[42] Dick Bryan, "Bridging Differences: Value Theory, International Finance and the Construction of Global Finance," in Alan Zuege and Peter Westra, (eds.), *Value and the World Economy Today*, New York: Palgrave Publishers, 2003, p. 64.
[43] Ackland, et al., "Financial Derivatives and Marxist Value Theory," p. 12.
[44] Rafferty and Bryan, "Financial Derivatives and Value Theory: Towards a Theory of Capitalist Money," p. 14.

This process of commensuration makes derivatives the anchor of the pricing system because these instruments determine the rate of conversion of one fragment of capital, which appear as an attribute of a given asset, into another.[45] For this reason, derivatives have become a new form of money commodity since they perform money functions of economic valuation, and at the same time, are traded goods.[46] More specifically, "derivatives are commodities whose primary function is the commensuration of other commodities."[47]

Derivatives, therefore, have fostered a process of meta-fetishization of commodities. While the fetishism of commodities refers to the way in which commodities conceal and substitute the social relations behind their production, meta-fetishization is the replacement of the flow of commodities themselves by the movement of prices. In other words, what is exchanged is not a commodity or labour itself, but the risk exposure and the expected profitability of a given set of assets, which is sold as a commodity.[48] This, however, does not mean that derivatives have only changed economic relations in symbolic ways. Rather, financial derivatives have a concrete impact on the ways in which prices, including wages, and ownership are determined, and capitalist competition transformed. Such a view on derivatives shows the social significance of these financial instruments in the process of accumulation. Derivatives, therefore, cease to appear as a neutral or even as a purely technical mechanism designed to minimise risk. Instead, they have become an inherent aspect of current capitalism.

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[45] Bryan and Rafferty, *Capitalism with Derivatives*, p. 130.
[46] Ibid., p. 132.
[47] Ibid., p. 153.
[48] Arjun Appadurai, "Commodities and the Politics of Value," in Arjun Appadurai (ed.), *The Social Life of Things: Commodities in Cultural Perspective*, Cambridge: Cambridge University Press, 1986, p. 50.

The Changing Nature of Capitalist Ownership and Competition

Derivatives have transformed ownership under capitalism. In the earlier stages of capitalism, the individual capitalist represented the owner of the means of production. Such form of ownership involved the separation of labour from the means of production, and capital competed as private firms. This changed with the emergence of the joint-stock company linked to industrial activities at the end of the nineteenth century, as the control of capital and possession over the material process was separated from ownership.[49] Ownership became only a claim on future profits on production that did not guarantee control rights.[50] This led to what Marx called the abolition of private property by the socialisation of capital.[51] More specifically, the joint-stock company provided the conditions to bring capital together to finance large-scale activities. Such a transformation allowed capitalists to overcome the difficulties involved in attracting sufficient resources by one owner or a single firm.[52] Simultaneously, the separation between ownership and possession required the creation of a secondary market where ownership rights could be transferred and traded. Ownership, therefore, became more

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[49] Alan Hughes and Ajit Singht, "Takeovers and the Stock Market," *Contributions to Political Economy*, 6, 1987, p. 73.

[50] Joint-stock companies emerged in the 17th century as a result of increasing trade between colonies and metropolis. In this period, most joint-stock companies retained some essential features of partnerships. This was reflected in the limits on the number of shares and approval and registration of new shareholders. Many of the initial joint-stock companies were involved in long-distance trade, with paid-in capital being dispersed together with any profits after the completion of an expedition. Geoffrey Poitras, "From Commercial Arithmetic to Life Annuities: The Early History of Financial Economics, 1478-1776," *Paper presented to the 1999 Meetings of the Canadian Economics Association,* Toronto, 28 June 1996, p. 8.

[51] Bryan and Rafferty, *Capitalism with Derivatives*, pp. 71-2.

[52] Ibid., p. 72.

liquid and mobile, which allowed for the further combination of capitals together into the stock market.[53]

Valuation in the joint-stock company at the end of the nineteenth century, despite being a social corporation, remained private in their internal calculations and operations.[54] In other words, the calculation of profitability and competitiveness of a firm was based on an internal evaluation of the company such as the firm's infrastructure, the annual return rates, production rates, sales, etc.[55] In this period, the corporation itself calculated its own market value in a context where capital competed between each other as public corporations. As a result, the joint-stock company strengthened the logic of competition in which high returns were not only the result of owners' preferences, as managers also enforced this logic in order to retain control over the firm.[56]

With the rise of derivatives, the nature of ownership and competition has been further transformed. It is worth noting that previous uses of derivatives in commodity markets did not in themselves transform the nature of capital. Bryan and Rafferty argue that derivatives were previously exchanged in individual financial transactions to settle in a very specific commodity market.[57] Nowadays, derivatives do not settle a particular financial transaction in one exclusive market. Instead, their ability to blend different

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[53] Bryan and Rafferty, *Capitalism with Derivatives*, p. 74.
[54] Ibid.
[55] In his study of the history of stock valuation models, Robert F. Soldofsky notes that formulas to calculate the value of a share focused on dividend payments, growth of dividends, and surplus profits internal to the company. "A Note on the History of Bond Tables and Stock Valuation Models," *Journal of Finance*, 21: 1, 1966, pp. 106-7.
[56] For instance, forward trade in grain used to take place in Amsterdam in the sixteenth century, where the the development of a forward contract for grain could be annulled after a certain time took place. Oscar Gelderblom and Joost Jonker, "Amsterdam as the Cradle of Modern Futures and Options Trading, 1550-1650," *Economy and Society of the Low Countries in the Pre-Industrial Period Working Papers*, 9, 2003, p. 6.
[57] Bryan and Rafferty, *Capitalism with Derivatives*, p. 94.

attributes of various assets – corn, cars, government debt, bank loans – into different exchange rates has challenged the common wisdom of ownership and competition. A buyer does not have to have ownership of a company or a share of the firm to take a part of the profits of a given corporation. Within a derivatives transaction, an investor does not have ownership rights over a company or a physical aspect of it. Rather, the investor only owns the right to buy and sell the future profitability of a company or future increases in the GDP of a country. As a result, different forms of money and capital of firms can be fragmented into financial assets that can be packaged, priced, and sold without being owned or physically exchanged, conferring only ownership over the risk-adjusted expected profitability of an asset.[58]

As Rafferty and Bryan argue, derivatives have also problematised the separation between credit and equity, since both attributes can be combined into a single commodity. For instance, a derivative might give the holder the option to exchange a company bond for a predetermined number of shares in the issuing company. The use of this instrument raises the question of whether the derivative holder owns a part of the company or lends money to the company. This example shows how derivatives have delinked ownership and exposure from the costs and gains of an asset or a liability.[59]

Derivatives, unlike the joint-stock company, do not only facilitate investment but also secure the value of assets in different spaces and times. Also, other agents external to the corporation can participate in the calculation of a firm's performance.[60] As a

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[58] Bryan and Rafferty, *Capitalism with Derivatives,* p. 78.
[59] Ibid., p. 70.
[60] Ibid., p. 76.

result, it is not only title owners and managers who have interests in imposing the logic of competition within a firm, but a wider myriad of financial participants have the need to intensify the process of competition within the firm and a national economy to attain more profits.

Derivatives have also become the way in which capital assets within and between firms can be commensurated in their performance. This has affected the economic evaluation of firms as derivatives have turned corporate private calculation into a socialised one.[61] Corporations do not evaluate their maximisation of profits directly as unified entities. Different assets within the firm – labour, physical infrastructure, sales and debts, for instance – are continuously being measured by derivatives on the basis of the existing and future profitability of its assets.[62] Capital competition then no longer occurs strictly in the form of inter- and intra- firm competition, but rather as capital itself.[63] The means of production, money and commodities are not isolated from the circuit once they are exchanged. Instead, these moments are continuously evaluated against other assets and, therefore, are integrated into the calculation of profitability of the whole circuit of capital.[64]

An approach to the role of derivatives in the exchange processes and changing forms of ownership is important in addressing the impact of these financial instruments in the economy. Still, the production of value and competition between labour processes

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[61] Bryan and Rafferty, *Capitalism with Derivatives*, p. 167.
[62] Ibid., p. 76.
[63] Ibid.
[64] Ibid., p. 174.

remain central to capital accumulation. Derivatives, however, add to competition and change its form, further disciplining capitalist social relations.

Labour, Market Discipline, and Derivatives

The turnover on derivatives markets is many times larger than the exchange and the surplus labour contained in real commodities, and yields in currency derivatives are also larger than the exchange of the actual currency in economic activities. This does not necessarily mean that derivatives are disconnected from real production. On the contrary, they affect how the price of a commodity or the value of a currency is determined. This shows that derivatives are not only hedging mechanisms that respond to price changes in real underlying assets, but that they are also influential in determining international competitive prices.[65] The nature of derivatives as commodity money has set a system of economic calculation that reconciles the value of different currencies and allows the daily evaluation of different assets. Both processes of pricing and benchmarking of profitability ultimately have effects on the price of labour. The existence of derivatives as a unit of measurement exerts competitive pressures on non-performing capital to achieve targets of profitability set internationally.[66] It is not enough for firms to increase their sales or their market share: derivatives impose pressures on labour processes so they remain competitive and profitable for the continuation of the circuit of capital at the international scale. In other words, workers have to meet international standards – that is,

[65] See: Dick Bryan, "The Pass the Rick Trick," *Workers Online,* 75, 2000.
[66] Dick Bryan, "The Internationalisation of Capital and Marxian Value Theory," *Cambridge Journal of Economics*, 19: 3, 1995, p. 436.

workers have to produce better and for cheaper than other countries to ensure profits.[67] This competitive process ultimately relies on disciplining labour as "workers and consumers."[68] Bryan and Rafferty argue that:

> Labour confronts the logic of capital not just as an abstraction, but as a more tangible concrete reality – that these forces that drive corporate policy are increasingly being expressed through the mathematical calculations of financial market participants.[69]

Derivatives, therefore, become a disciplinary mechanism as profitability is now being directly determined by international conditions mediated by financial markets.

Derivatives, as a disciplining aspect of capitalist social relations, have become an effective spatially-dispersed mechanism that centralises enforcement on labour movements and workers to comply with global criteria of profitability. Working classes are all bound to a set of money forms that are dependent on calculating future time and spaces in the international market of derivatives. Every act of production and the labour of workers from every corner of the world are measured against each other through derivatives.[70]

By disciplining capitalist social relations, derivatives have facilitated the international expansion of capital as a social relation in the form of production. Since derivatives preserve the value of capital across time and place, money can be moved more easily across currencies. This assists – and becomes necessary for – the expansion

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[67] Ron Martin, "Stateless Monies, Global Financial Integration and National Economic Autonomy: the End of Geography?" in Stuart Corbridge, et al. (eds.), *Money, Power and Space,* Oxford: Blackwell, 1994, p. 364.
[68] Rafferty and Bryan, "Financial Derivatives and Value Theory: Towards a Theory of Capitalist Money," p. 23.
[69] Bryan and Rafferty, *Capitalism with Derivatives*, p. 75.
[70] Pryke and Allen, "Monetized Time-Space: Derivatives-Money's New Imaginary?" p. 273.

of production and the exploitation of labour. At the same time, wages become more tied to productivity in the workplace. These workplaces are compelled to adjust themselves to productivity and competitiveness internationally.

The disciplining aspect of financial derivatives shows how these instruments are the expression of alienated forms of social relations rather than a neutral means of exchange and hedging of risks. The social character of derivatives as social and class power is revealed since those participating in derivatives markets can influence the 'what, when, and where' money does to production and to social reproduction of labour.

The Territoriality and Nationality of Global Derivative Markets

Derivatives do not entail the disappearance of territorial social relations located within nation-states. Rather, social relations of production located within nation-states remain the basis for the existence of derivatives and capital accumulation. Derivatives have attempted to resolve the space differentials that emerge from the territorial definition of the worthiness of currencies by giving momentary continuity to the circuit of capital. Yet, derivatives do not end exchange rate volatility, since discontinuities do not disappear with trade or arbitrage. Discontinuities that emerge from time and space differentials – such as national interest rates and national currencies – are sustained in different national localities.[71] They are also the basis that drive profits and instability in derivatives markets, and therefore become an integral feature of global accumulation.

As such, derivatives play on territorially-differentiated interest and exchange rates, which are shaped and secured by the state. The nation-state can drive derivatives

[71] Bryan, "Bridging Differences: Value Theory, International Finance and the Construction of Global Finance," p. 7.

markets by influencing interest and exchange rate differentials. Also, the breakdown of the link between the gold standard and money has made the local and political character of money even more important, since in times of instability, currencies become tied to "'high quality' money."[72] Location, therefore, becomes central, since each currency is backed by a particular state. The influence of space differentials in financial markets shows that the territoriality of nation-states is central to the existence of derivatives.

This can be seen when there is an attack on a bank's reserves through foreign exchange swaps and spot exchange markets. As Peter Garber notes, speculators might, on the one hand, sell a 'weak' currency through financial contracts to a bank at relatively long maturities in exchange for a 'strong' currency such as U.S. dollars. A central bank, on the other hand, sells the 'weak' currency, which is also the national money, at the spot rate. This leads to a maturity mismatch between the 'weak' and the 'strong' currency. As a result, there is a need to cover the spot sale, but this will only be received in the long term in the forward contract. The central bank, therefore, needs to engage into a foreign currency swap since it is the ultimate counterparty in these transactions. The central bank can make a forward intervention, absorbing spot sales of its currency without interfering in the spot market. This results in the central bank supplying domestic credit to the short seller (in this case, the commercial bank). Subsequently, the seller has to deliver the 'weak' currency to the central bank and this in turn becomes a central bank's loan.[73] The central bank becomes the sole defender of the exchange rate.

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[72] David Harvey, *Limits to Capital*, New York: Verso, 1999, p. 38.
[73] Peter Garber, "Derivatives in International Flows," *National Bureau of Economic Research Working Papers* , 6623, 1998, pp. 21-5.

Nation-states have also provided the institutional conditions necessary to advance the derivatives market. For instance, the breakdown of the Bretton Woods and the emergence of Euromarkets were partly a political outcome of state decisions. This is also the case of state legislations that allow investment banks to place corporate and state bonds internationally.[74] The state has also transformed its own role to sustain the derivatives market. The role of the state in securing production and social reproduction of labour through employment, wages, and public services has been replaced by its role in the management of money – particularly in the setting of inflation rates and as lender-of-last resort.

The role of the state in this process is particularly evident in the relationship between exchange rates and derivatives. Derivatives and exchange rates have been increasingly tied to one another, and more specifically, the content of financial derivatives often involves changes in currency rates. As a result, the value of a derivative can be directly influenced by exchange rate changes because currency price expectations can hasten a shift of funds into a financial instrument denominated in another currency, hence changing the outcome of a derivative operation. The conditions of currency prices are at the same time influenced by the state in order to secure investment in those assets linked to its national money.[75]

Derivatives, as a new money commodity, not only attempt to mediate the contradictions between the national scale of state regulation and the global scale of

[74] Leo Panitch and Sam Gindin, "Finance and the American Empire," in Leo Panitch and Colin Leys (eds.), *Socialist Register 2005: The Empire Reloaded*, London: Merlin Press, 2004, p. 53.
[75] Mica Panic, "The Bretton Woods System: Concept and Practice," in John Grieve Smith and Jonathan Michie, (eds.), *Managing the Global Economy*, Oxford: Oxford University Press, 1995, pp. 71-2.

accumulation, but also the state by targeting labour as the main adjustment mechanism that secures profitable rates of return internationally. This adjustment was almost mechanical during the Bretton Woods era, as exchange rates were fixed and capital movements more controlled. A decline in exports would mean a large outflow of capital and a decline in the foreign reserves supporting the national currency. This necessarily led to low prices and low wages, which promoted exports and investment in order to bring foreign currencies back in order to sustain the value of the national money in accordance with established fixed exchange rate.[76]

In the current context of floating exchange rates, however, currency price stability is no longer guaranteed. Countries have surpluses and deficits in their balance-of-payments without major changes in the price of their currency. This indicates that adjustment of labour costs *via* inflows or outflows of money is no longer automatic.[77] For this reason, the nation-state needs to intervene in order to implement state legislation, wage norms and labour conditions to secure competitiveness and productivity at the global scale.

With derivatives, the 'expected profitability' of a firm, *via* the cutting of social and wage costs and productivity increases, remains conditioned by the social, legal, and economic conditions imposed upon it by the state and the balance of class forces in which capital is located. Wages must fall to compensate for the lack of productivity and to sustain the value of a currency as opposed to a change in inflation target and exchange

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[76] In this period, the balance-of-payments accounts intended to measure a country's ability to meet its obligation to exchange its currency for other currencies or for gold at fixed exchange rates. To meet this obligation, countries maintained a stock of official reserves in the form of foreign currencies that they could use to support their own currency. Bryan and Rafferty, *Capitalism with Derivatives*, p. 110.

[77] Bryan and Rafferty, *Capitalism with Derivatives*, p. 112.

rates. Labour is also required to work more for less according to this international calculation of competitiveness. This occurs in a nationally-defined context, where the reproduction of capital and the competitiveness of labour needs to increase faster in one given country than in others. This is also facilitated through the rescaling of the state to intensify competition within the nation-state and secure the territorialisation of capital in a larger space. As such, the mechanisms to enforce capital and labour adjustment to the international criteria of profitability are still located in the nation-state, which implements policies of competitiveness and labour productivity. In this way, labour bears the costs of international competition as exchange and inflation rates are maintained to suit the needs of different capitals, and fiscal discipline is ensured to guarantee the worthiness of a currency.

An understanding of the contradictory relationship between financial derivatives and state territoriality shows that both processes are not merely opposed to one another. The power of the state does not decline in line with the emergence of derivatives. Instead, derivatives have become part of a new process of regulation. Because of the international circulation of currencies beyond their national jurisdiction, derivatives allow states to participate in – and influence – financial markets beyond their territory to pursue a particular domestic agenda.[78] This is the case of central bank intervention in currency swaps in international financial markets. As a result, derivatives become a central aspect in the state regulation of international finance. The fact that derivatives remain outside national regulation allows states to use derivatives as a policy instrument to influence a

[78] Bryan and Rafferty, *Capitalism with Derivatives*, p. 208.

national policy agenda without targeting any specific economic sector. At the same time, the state is able to externalise the causes of national economic austerity and labour discipline onto international financial markets.

Conclusions

Derivatives have transformed the nature of accumulation by providing a new form of money to secure continuity within international accumulation. As a new form of money, derivatives have become a disciplinary mechanism of social relations since they entail the constant international valuation of national economies and the performance of relative labour costs. This performance takes the form of profits, labour costs, public debt interest rates, and currency worthiness. These are all fragmented, packaged, and sold as commodities themselves in the form of financial derivatives.

While derivatives attempt to maintain the continuity of international accumulation, geographical discontinuities created and reproduced by nation-states also continue to exist. The ability of capital to realise itself on a global scale is still dependent on the creation of real production processes at the national and local scales. This, in turn, rests on the capacity of the capitalist state to guarantee the quality of money within its own territory, to secure the production of the means of debt repayment, and to contain labour demands within the confines of the capitalist relation. The 'national economy' is being reproduced in global financial markets, since national territoriality influences the ways in which capital moves to certain locations or the particular form of derivatives.[79]

[79] Dick Bryan, "Global Accumulation and Accounting for National Identity," *Review of Radical Political Economics*, 33, 2000, p. 60.

Chapter 9

The Mexican Nationality of Global Financial Markets

The peso crisis of 1994 has often been regarded as the expression of the malfunctioning of commercial banks, the outcome of ineffective state policy, or the result of political instability (such as the Chiapas uprising). In each of these cases, the Mexican nation-state is seen as an obstacle to the internationalisation of capital. This dichotomisation of the nation-state and international accumulation cannot explain why the Mexican nation-state continues to exist along side international financial markets. This chapter argues that the Mexican state has remained pivotal in reproducing global financial markets within the Mexican social formation. The Mexican state has created and maintained the territorial differentials – namely state regulations, a strong currency and high interest rates – that set the conditions for the deepening of capital markets, mainly derivatives. Derivatives set the conditions for the further integration of Mexico into the international circuits.

First, the chapter offers an analysis of several approaches to Mexico's financial crisis of 1994 and discusses their limitations in understanding the role of derivatives and the state in the Mexican economy. Second, the chapter shows an overview of the state policies and responses in the onset and the aftermath of the 1994 peso crisis. Third, the role of the Brady bonds in setting the conditions for a burgeoning derivatives market linked to Mexico's currency and interest rates is examined. Fourth, different transactions in derivatives markets and the state monetary and financial policies that were carried out before and after the peso crisis are examined. Fifth, the role of the centrality of the

Mexican state in promoting derivatives and their disciplinary effect is also discussed. Sixth, the chapter discusses how the study of derivatives in the Mexican economy show the intersection between national state regulation and the politics of scale of the Mexican state, linking finance and Mexican state territoriality in the process of global accumulation.

Politics and Financial Speculation: The Peso Crisis Debate

The 1994 peso crisis brought about a series of questions regarding the feasibility of the Mexican model of economic liberalisation to achieve economic growth. Such interrogations were embedded in mainstream and critical debates regarding the role of finance and the state in Mexico's financial crisis of 1994. Several economic rationalist approaches pointed out that the crisis was the result of the Mexican current account deficit. In a context of a pegged exchange regime, what kept the Mexican peso over-valued relates to its unit labour costs. Imports became cheaper and labour costs increased, hence imports increased and direct investment to finance exports declined.[1] The process of bank liberalisation occurring in this period also caused the expansion of credit. The OECD suggested that banks competed for market share, extending credit without adequate risk assessment and holding poor quality bank portfolio.[2] As such, financial deregulation contributed to a decline in private savings.[3]

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[1] Organisation of Economic Cooperation and Development, *México,* OECD: Paris, 1995, p. 6; Luis Foncerrada, "Public Debt Sustaintability. Notes on Debt Sustentability, Development of a Domestic Government Securities Market and Financial Risks," *Análisis Económico*, 20: 44, 2005, p. 266; Nora Lustig, *Mexico: The Remaking of an Economy*, Washington: Brookings Institute, 1999, pp. 146-7.
[2] Organisation of Economic Cooperation and Development, *México*, p. 4.
[3] Francisco Gil Díaz, "The Origins of Mexico's 1994 Financial Crisis," *The Cato Journal*, 17: 3, p. 1.

Jeffrey Sachs, Guillermo Calvo and Enrique Mendoza indicated that the expansion of credit, current account deficit and the economy's reliance on short-term portfolio loans created misalignments in the real economy. In other words, the authorities did not secure the necessary amount of foreign reserves through a current account surplus to protect the economy against potential capital flight.[4] According to this analysis, the root of the crisis was a shift in investors' expectations that originated from the Zapatista uprising, several political assassinations, and the flawed state responses to these political events.[5] Instead of tightening fiscal and monetary policies through an increase in interest rates and devaluing the peso above the band in March 1994, the state chose to increase the expansion of credit and replace government debt denominated in pesos to dollars to encourage investment in the Mexican currency for electoral purposes.[6] As such, Mexico's fiscal position and foreign bank reserves became even more exposed to exchange rate risk. Francisco Gil and Agustín Carstens contended that the causes of the crisis were to be found in the combination of a semi-fixed exchange rate, the explosive availability of international short-term capital, and the cumulative effect of the repeated political shocks that affected Mexico during 1994.[7]

The neo-Weberian approach understood the 1994 peso crisis as a moment of economic unbalance that needed to be managed to restore bank liquidity and macro

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[4] Jeffrey Sachs, et al., "The Mexican Peso Crisis: Sudden Death or Death Foretold?" *Journal of International Economics*, 41: 3, 1996, p. 265; Guillermo Calvo and Enrique Mendoza, "Mexico's Balance of Payments Crisis: A Chronicle of a Death Foretold," *Journal of International Economics*, 41: 3, 1996, p. 236.
[5] Calvo and Mendoza, "Mexico's Balance of Payments Crisis: A Chronicle of a Death Foretold," p. 237; Organisation of Economic Cooperation and Development, *Economic Survey, México,* p. 26.
[6] Sachs, et al., "The Mexican Peso Crisis: Sudden Death or Death Foretold?" p. 266.
[7] Agustín Carstens and Francisco Gil Diaz, "Some Hypotheses Related to the Mexican 1994-95 Peso Crisis," *Banco de Mexico Documento de Investigación*, 9601, 1996, p. 19.

economic stability. Proponents of this approach argued that the liberalisation of capital was made without adequate regulatory and supervisory state institutions. This is reflected in the absence of state supervision when banks reported a positive net income during the peso crisis, while provisions for loans exceeded net incomes. This explanation also understands the effects of the absence of an appropriate framework to have been further aggravated by the lack of experience of the newly privatized banks (for example, in matters regarding credit analysis and investment markets skills), thereby causing a lack of liquidity in the Mexican financial system.[8] The existence of partial information was also considered to be a factor that also caused the 1994 peso crisis. This approach considers that the full disclosure of borrowers' information was not feasible during the credit boom in Mexico. In turn, these information problems led to the rapid expansion of bank balance sheets during a lending boom and generated a deterioration of those balance sheets.[9]

Marxist analysis of the Mexican peso crisis has also considered that the economy's reliance on short-term portfolio investment and capital mobility were the source of the crisis. Contrary to the previous debate, these critical approaches condemn financial mobility and speculation. These explanations contend that the policies of the World Bank and IMF imposed a model of economic liberalisation that made the country

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[8] Michael Gavito, et al., "Recovery after Crisis: Lessons for Mexico's Banks and Private Sector," in Riordan Roett (ed.), *Mexico's Private Sector: Recent History, Future Challenges*, New York: Lynne Rienner Publishers.

[9] Inter-American Development Bank, "Overcoming Volatility in Latin America," *Report on Economic and Social Progress in Latin America*, Baltimore: John Hopkins University Press, 1995.

dependant on portfolio investments held by foreign investors.[10] Short-term portfolio investments, it is argued, channelled money away from productive activities towards speculation.[11] Within this view, there is also an emphasis on the relationship between the Zapatista uprising in Chiapas and the peso crisis of 1994. The relation between the two events is employed to illustrate how capital and class struggle are not isolated phenomena.[12] Rather, capital is class struggle and expresses itself through financial crisis. John Holloway suggests that the violence of capital through the mobility of money is exerted when capital flees because of its inability to subordinate labour.[13] According to Holloway and Alberto Bonnet, this was the case of the peso crisis in Mexico where capital sought to escape the insubordination of labour expressed in the Zapatista rebellion. In this way, as Bonnet argues, "each and every corner of the planet becomes a stage in the game of global capital flows, whilst each and every point of class struggle, including the Lacandon jungle, is at the same time a barrier against global money-capital."[14]

While these accounts have a different normative ground in their interpretations of finance and the peso crisis, they remain limited in understanding the qualitative changes

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[10] Eugenia Correa, "FOBAPROA e IPAB: Crisis y Ocaso de los Bancos Mexicanos," en Eugenia Correa y Alicia Girón (eds.), *Crisis y Futuro de la Banca en México,* México: Porrúa, 1999, pp. 75-6; Teresa López González, *Fragilidad Financiera y Crecimiento Económico en México*, México: Plaza y Valdes, 2001, p. 105; John Saxe-Fernández, "América Latina: Globalización e Imperialismo en México," *Problemas del Desarrollo*, 30: 117, 1999, p. 90; Arturo Huerta, "La Globalización como Causante de la Crisis Económica Actual," *Problemas del Desarrollo*, 30: 117, 1999, p. 105. See also: Hector Guillen Romo, *La Contrarevolución Neoliberal*, Mexico: ERA, 1997.

[11] Noemí Levy Orlik, "Desregulación Financiera: Efecto sobre el Comportamiento de la Inversión y su Financiamiento en México," *Problemas del Desarrollo*, 30: 119, 1999, p. 99.

[12] John Holloway, "Capital Moves," *Capital and Class,* 57, 1995, p. 144.

[13] See: John Holloway, "Is the Zapatista Struggle an Anti-Capitalist Struggle?" *Rebeldía*, 1, 2002.

[14] Alberto Bonnet, "The Command of Money-Capital and Latin American Crises," in Werner Bonefeld and Sergio Tischler (eds.), *What is to be Done? Leninism, Anti-Leninist Marxism and the Question of Revolution Today*, Aldershot: Ashgate, 2002.

in capitalism that were expressed in the 1994 peso crisis. These debates see the crisis as the outcome of investors' changing expectations, and the lack of information and appropriate institutional framework or speculation. The economic rationalist and the neo-Weberian approaches consider this to be an inevitable characteristic which states have to manage. The critical approach, in contrast, regards the speculative and mobile character of finance as detrimental to production and as an external pressure on labour. These analyses understand the peso crisis as a national question, and more specifically, whether or not the nation state is able to control global finance. This reproduces a dualistic account of the global scale of finance and the nation-state. Such an explanation reduces considerations of how finance functions and is reproduced by the territoriality of the nation-state to issues of national control.[15]

Likewise, political events such as the Zapatista uprising are seen as triggering the crisis because of its effects on investors' expectations. But these arguments cannot explain why investment was still channelled to peso derivatives even months after the Zapatista rebellion. This is due to the fact that these explanations tend to ignore the form that portfolio investment takes and dismiss it as herding behaviour or as speculative attacks. Attention to the complexities of financial instruments is, however, central to understand the ways in which the state plays a role in how finance operates and how finance transforms capitalist expansion and competition. This is the case of derivatives, which had an important role in bringing about the peso crisis and articulating the global scale of accumulation with the territoriality of the Mexican nation-state.

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[15] Dick Bryan and Michael Rafferty, *Capitalism with Derivatives: A Political Economy of Financial Derivatives, Capital and Class*, London: Palgrave, 2006, p. 29.

Capital Markets and the Peso Crisis of 1994

A decade later after the 1982 crisis, the re-emergence of the economy became a 'hot' business among Wall Street investors and the owners of newly privatised Mexican enterprises. American securities firms steered capital back to Mexico to profit from the economic reforms implemented by De la Madrid's and Salinas' administrations. Among the specific reforms that drove the interest of investors were privatisation and the tightening of monetary policy, such as public spending constraints, low inflation, and a strong currency.[16]

A strong peso was guaranteed by the floating of the peso within an exchange rate band during Salinas' presidency. Here, Mexico's central bank intervened in the market by buying pesos when its value was low or selling pesos when the value was high in order to keep the Mexican currency within the established band. The peso then became an attractive investment, as its value was kept high and stable. The Mexican state also issued public debt denominated predominantly by pesos with high interest rates. The Mexican state's commitment to currency stability made these public bonds appealing for investors since these debt instruments guaranteed high yields. State policy also ensured the value of money as it converted from one currency to another through the exchange rate band. Likewise, the Mexican state's monetary policy and fiscal discipline assured investors that international reserves and profits from privatisation would be used to maintain the value of the peso rather than for social spending. This guaranteed investors

[16] Matt Moffett, "Long-Sickly Mexico has Investment Boom as Trade Hopes Grow," *Wall Street Journal*, 24 May 1991; Matt Moffett, "Mexican Conglomerate Cuts Costs and Learns There is Life after Debt," *Wall Street Journal,* 26 July 1991.

the means of payment that sustained the value of the Mexican currency and high returns on peso investments.

Between 1988 and 1994, there were four main bonds issued by the Mexican state besides the Brady bonds. *Certificados de la Tesorería* (*cetes*) were peso-denominated treasury certificates indexed to the dollar. By the end of 1993, these securities accounted for 40 percent of the market and had maturity periods ranging from 26 days to a year. Another major instrument was the inflation-indexed bonds known as *ajustabonos*, which by 1993 accounted for 30 percent of the market. This instrument paid a fixed premium over inflation with maturities of three or five years. The other two government securities were *bondes*, which had a floating coupon with one or two-year maturity, and *tesobonos*, which were dollar-denominated public debt.[17] Besides the high coupons of government securities, the Mexican state bond market was also favourable to investors because it was tax exempt.

The high yields in Mexican public debt occurred in a context of financial deregulation in the U.S. These measures included the decriminalisation of fraudulent financial practices such as inflating income, hiding expenses, and the use of new financial instruments to increase the company earnings and avoid costly regulation.[18] This provided U.S. investment banks with incentives to spread financial innovation abroad, particularly to their Mexican neighbour. The shift of financial innovation to the Mexican peso was further encouraged by the differences between yields in the Mexican and the American bond market. The yields in American treasury bills, for instance, were much

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[17] Geoff Dyer, "Foreigners' Vote of Confidence in Mexican Bonds," *Euromoney,* September 1993, p. 301.
[18] Frank Partnoy, *Infectious Greed,* New York: Times Books, 2003, pp. 186-7.

lower than those in Mexican public debt. While *cetes* gave an annual return for dollar investors of at least 8.5 percent, American-treasury bills' yield was about percent three and four percent (See Figure 17).[19]

In the context of a strong peso, this indicated that peso investments generated gains that surpassed any downward movement of the peso within the currency band. The issuing of peso-denominated public debt gave further advantages to the state bond market. While credit-rating agencies gave the Mexican public debt a low grade in its credit in dollars, these same agencies gave peso-denominated debt near-investment grade ratings.[20] Mexico's credit rating in pesos was higher than it was in U.S. dollars because it was more feasible for the Mexican central bank to control the money circulation in pesos. Also, it was less expensive for the Mexican government to pay peso-denominated debt than that public debt denominated in U.S. dollars.[21]

State regulations also prevented Mexican firms from borrowing in foreign currency. Peso loans were unappealing for Mexican companies, since they were expensive and had a maximum-fixed rate maturity of one year for corporate borrowers. The cost of borrowing in pesos had other disadvantages. The Mexican state, for instance, imposed a 10 percent ceiling on foreign currency funding to banks. Banks or stocks held by domestic investors were further subjected to a withholding tax equivalent to the coupon minus 1.7 percent, additionally burdening corporate borrowing in Mexico.[22]

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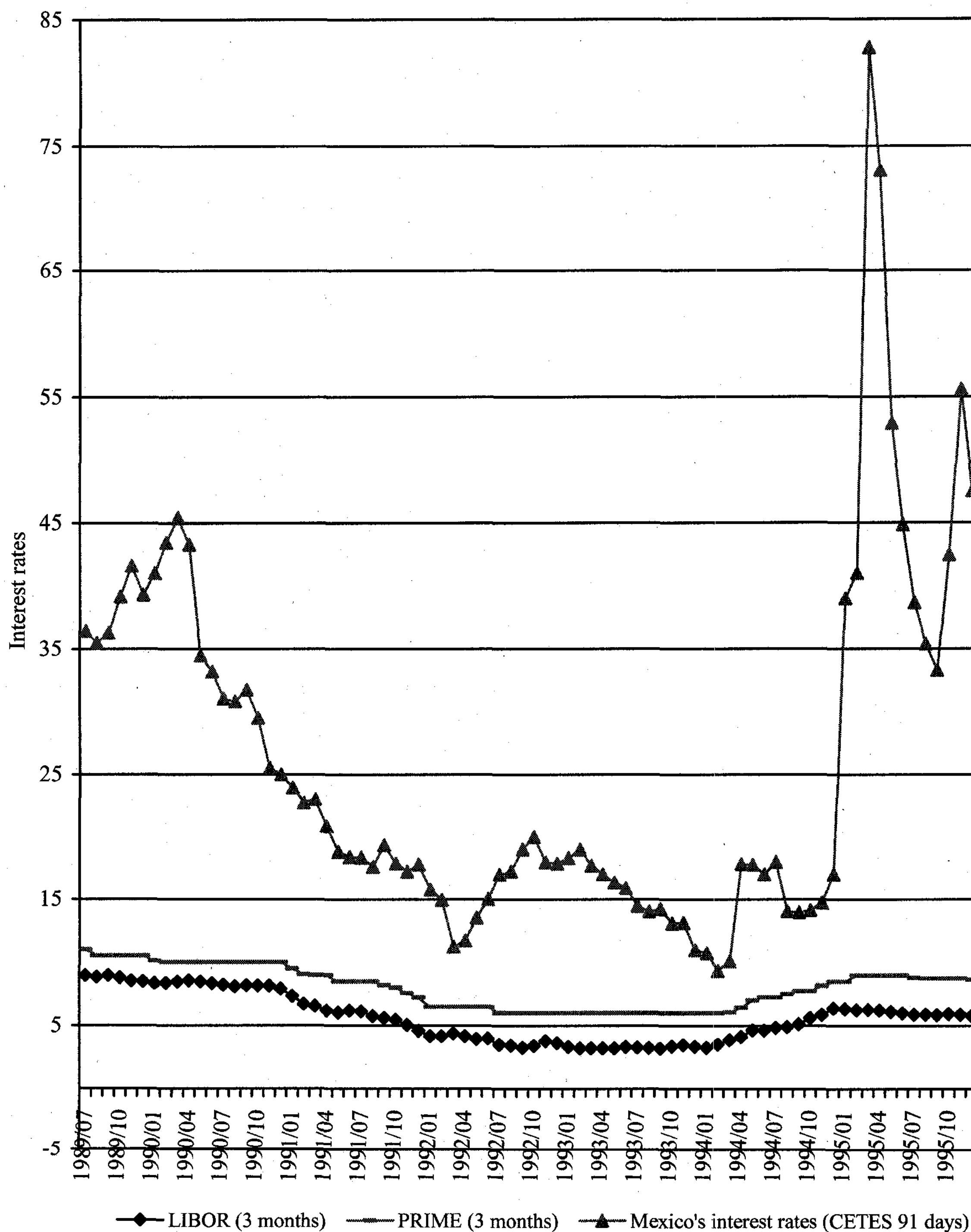
[19] Anonymous, "Mexico's peso: Gone Tomorrow?" *The Economist*, 29 May 1993, p. 87.
[20] "Finance: Falling in Love Again," *The Economist*, 22 August 1992, p. 63.
[21] Frank Partnoy, *Fiasco: The Inside History of a Wall Street Trader,* New York: Penguin Books, 1999, p. 81.
[22] Dyer, "Foreigners' Vote of Confidence in Mexican Bonds," p. 303.

Figure 17. Interest Rate Differentials



Source: Banco de Mexico, *Información Económica y Financiera,* 2006.

Other state regulations prevented legally-denominated foreign firms from further participating in Mexican financial markets. While the Mexican state opened the public debt market to foreign addresses, it prohibited foreign banks from lending in Mexican pesos. Foreign financial institutions could not provide other peso denominated products or establish foreign currency and security trading operations in Mexico.[23] In addition, foreign investment in bank or corporate holding was liable to pay 15 percent tax on coupon payments. Mexican financial markets remained highly regulated by the Mexican state. Concurrently, the Mexican state did not provide a regulatory setting for the existence of a hedging or derivative market within Mexico. This gave the state greater control over monetary policy. The only mechanism to hedge forward interest rates were based on the *coberturas*. These were peso forward agreements issued by private banks, but were highly taxed and regulated.[24]

Monetary policies and interest rates divergences between the United States and Mexico provided the opportunity for profit. High interest rates, stable exchange rates, and state protection over several Mexican firms and banks provided the latter with the conditions to access cheap sources of funding and short-term profits without having to wait for investment returns in productive activities. While Mexican banks and other firms remained interested in participating in the peso market and borrowing in dollars, they were also concerned with Mexican regulations and taxation. As a result, Mexican banks and various companies required financial instruments that could minimise the risk of devaluation and interest rate fluctuations and could meet their off-balance sheet

[23] Partnoy, *Fiasco,* p. 78.
[24] J.C. Louis, "Playing the Peso," *Derivatives Strategy*, February 1996.

financing needs to avoid state regulations.[25] On the one hand, international investment banks considered Mexican financial groups a profitable market for U.S. dollar lending. For this reason, several Wall Street firms were eager to provide the financial engineering to Mexican firms and American hedge funds. Mexican firms, on the other, needed these investment banks' services in order to circumvent accounting rules, legal regulation, and profit from Mexican capital markets.[26]

Because of this convergence of interests, derivatives linked to the peso were one of the most dynamic markets in global finance and the main sector driving the Mexican economy. By 1993, Mexico had the largest capitalisation among emerging markets of 140 billion dollars in derivatives transactions.[27] Each swap operation was worth approximately 50 million dollars. Among the largest providers of derivatives linked to the Mexican peso market were Morgan Stanley, JP Morgan, Merrill Lynch, Bear and Sterns, First Boston, and Salomon Brothers.[28]

Despite the amount of capital inflows into the country, investors started withdrawing their assets in pesos. This reduced the foreign reserves of the Mexican central bank. To encourage confidence in the Mexican currency, the Mexican central bank decided to buy *tesobonos* in order to maintain the monetary base and prevent interest rates from rising. This caused an even more dramatic decline in dollar reserves, which made it difficult to sustain the peso within the exchange rate band. On December 20th, 1994, the Mexican government widened the lower limit of the official trading range

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[25] Murray, "Mexico Battles to Build Derivatives," p. 88.
[26] See: Partnoy, *Fiasco;* Partnoy, *Infectious Greed.*
[27] Robinson, "Cash-hungry Latins Love Equity Derivatives," p. 35.
[28] Ibid., p.34.

for the peso. In addition, the government continued to maintain a maximum daily slippage against the dollar at 0.0004 pesos per dollar. Pedro Aspe Armella, the Mexican Finance Minister at the time, announced to investors that the Mexican government was committed to maintain the same monetary and fiscal policy and claimed that the widening of the exchange band was only a measure implemented to discourage speculation and increase exports.[29] The widening of the currency band resulted in an immediate 12 percent devaluation of the peso from 3.47 pesos per dollar to 3.88 pesos per dollar. On December 22nd, the Mexican central bank allowed the peso to float freely against the dollar because it did not have sufficient foreign reserves to sustain the value of the peso against the dollar. As a result, the peso fell to 4.80 pesos per dollar. In the following months, the peso continued to fall until it reached 6.27 per dollar on June 30, 1995.[30] The loan book of Mexican banks also performed poorly. The percentage of due loans in September of 1994 was approximately nine percent for the most important banks. Once devaluation policies were carried out, the loss reserves among the two biggest banks amounted to 82 percent.[31] This, in turn, led to a liquidity crisis in the banking system.

After the crisis, the Mexican state attempted to convince investors of the potentials of the Mexican economy. On January 1995, Guillermo Ortiz, the new Minister of Finance, flew to New York to convince institutional investors to put aside their

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[29] Craig Torres, "Headed South: Mexico's Devaluation Stuns Latin America," *Wall Street Journal*, 22 December 1994.

[30] Craig Torres, "Headed South: Mexico's Devaluation Stuns Latin America."

[31] Peter Garber, "Transition to a Functional Financial Net in Latin America," *Paper prepared for the Inter-American Development Bank Conference on Safe and Sound Financial Systems: What Works for Latin America*, Washington, September 27-28, 1996, p. 15.

mistrust in Mexican monetary policy. He assured them that Mexico would draw on 18 billion dollars from foreign government aid and commercial bank credit lines, five billion from sales of longer-term government bonds to foreigners, and a billion in repatriation funds in order to cover public debt obligations. Also, Ortiz presented to Wall Street an ambitious privatisation plan. This plan consisted in the sale of airports, ports and toll roads for two billion dollars, satellites for 1.5 billion, power plants for six billion and government holdings of bank stocks for approximately one billion dollars. [32]

Wall Street lobbied the U.S. government to assist the Mexican government with loans. Despite the U.S. Congress' opposition to this loan, Bill Clinton's administration provided the Mexican state with a 20 billion dollar loan to be restructured as low interest swaps between the two countries.[33] The United States agreed to guarantee long-term Mexican government bonds, which were to be sold in the international financial markets. In the event the Mexican government was unable to make payments on those bonds, the United States government would meet the outstanding obligations. This reduced the risk of default to potential buyers and allowed the Mexican government to issue its bonds (and thereby acquire the bond-purchasers' money) at a much lower interest rate.[34] The U.S. loan was part of the 52 billion dollar rescue package assembled by the U.S.

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[32] Craig Torres and Thomas Vogel, "Ortiz Pushes Rescue Plan," *Wall Street Journal*, 6 January 1995.
[33] By 1997, the Mexican state paid this loan to the US Treasury, a victory for the Clinton Administration.
[34] In the case that the US had to pay Mexico's debt, the Mexican government would pay back the United States with proceeds from Mexican oil sales. Mexico's state-owned oil company, PEMEX, was required to report financial data to the United States Treasury so that it could be assured that oil revenues would be sufficient to satisfy potential United States obligations. See: Eric Dorkin, "Development, the IMF and Institutional Investors," *Transnational Law & Contemporary Problems Law Journal*, 9: 35,1999.

government and other agencies. The package included 18 billion from the International Monetary Fund, and 10 billion from the Bank of International Settlements.[35]

Trading Mexico: Brady Bonds, Financial Derivatives, and the Peso

The debt crisis and the structural adjustment of the 1980s set the conditions for the emergence of a dynamic derivatives market linked to Mexican exchange and interest rates. The restructuring of the Mexico's syndicated debt through the Brady bonds facilitated the process of dividing and trading different parts of sovereign debt. More specifically, the Brady plan, on which the bonds were based, called for a write-down of Mexican sovereign debt to international bank syndicates under the voluntary conversion of commercial loans to bonds collateralized by U.S. Treasury bills. Through this securitisation, the bank loans owned by a sovereign debtor were repackaged as bonds, which were offered to the public. As a result, the bank-loan holder could exchange their sovereign loans for a menu of Brady bonds options. The bonds allowed for the dissemination of risk across a heterogeneous group of investors and allowed investors to price the debt without burdening a particular organisation.[36] In this way, bank syndicates ceased to be the owners of the debt, and instead they were only exposed to the performance of the debt and its interest rate risk.[37] Through the Brady bonds, the Mexican state could also diminish its sovereign debt by buying these bonds on the secondary market at a discounted price.

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[35] Craig Torres, "Mexico, Banks Hit Obstacles on Credit Lines," *Wall Street Journal*, 23 March 1995.

[36] Randall Dodd, "Derivatives, the Shape of International Capital Flows and the Virtues of Prudential Regulation," *World Institute for Development Economics Research Discussion Paper No. 2002/93*, Washington, 2002, pp. 3-5.

[37] John Nolan, "Emerging Market Debt and Vulture Hedge Funds: Free Ridership, Legal and Market Remedies," *Financial Policies Forum, Special Report 3*, 2001, pp. 4-5.

The Brady bonds represented a financial innovation that had great effects on the shape of capital flows to Mexico during the 1990s. From the 1970s to the early 1980s, financial flows to Mexico were primarily syndicated foreign bank loans with variable rates. This kind of debt made the borrower carry the exchange and interest rate risk, while the lender held a credit risk. The repackaging of sovereign debt through Brady bonds, in contrast, shifted risk away from investors who did not want it and towards those more willing to bear it.[38] The Brady plan then represented one of the new mechanisms to hedge risks in capital markets. It also signalled the return of the Mexican state to capital markets as lender and borrower.

This fragmentation of restructured Mexican debt also allowed for its sale with other assets through derivatives markets. Through this engineering, financial firms in Wall Street could repackage bank debt and Brady bonds into a multi-part security. The underwriting of these derivatives produced profits for companies such as Merrill Lynch, JP Morgan, First Boston, Chase, Bear and Stearns, and Salomon Brothers in fees. Volumes of secondary markets trading rose from under 20 billion a year to over 100 billion dollars in 1991. In this way, Wall Street created a lucrative business in emerging market derivatives, "which mixed and matched debt with add-ons such as foreign exchange options or interest rate products." [39]

Derivatives linked to the Mexican peso were customised for investors. The most commonly used derivatives were structured notes, total return swaps and equity swaps. An example of structured notes was the instrument created by Morgan Stanley for the

[38] Nolan, "Emerging Market Debt and Vulture Hedge Funds," p. 4.
[39] Anonymous, "Finance: Falling in Love Again," p. 63.

Banco Nacional de México (Banamex). These notes were called Peso Linked U.S. Dollars Secured Notes or PLUS I. PLUS I notes were derivatives created to help Banamex remove undervalued and illiquid Mexican government bonds – *ajustabonos* – from its balance sheet without recognising the sale publicly.[40] In order to attract buyers for these notes, Banamex decided to create an investment grade bond denominated in U.S. dollars. The task required considerable financial engineering, including Banamex's creation of an independent offshore company in Bermuda that could buy the Mexican bank's *ajustabonos*.[41] The creation of the Bermuda company had two advantages from the point of view of Banamex. On the one hand, the Bermuda firm allowed Banamex to overcome the Mexican legislation that prohibited Mexican banks from providing the collateral required in some derivative operations.[42] On the other hand, the location of this company meant that the off-shore company did not have to pay taxes. The result of this financial engineering was a dollar-denominated bond with an AA- Standard & Poor's rating and a riskier under-rated class of bonds that Banamex kept.[43]

By retaining the riskier bond – about 20 percent of the *ajustabonos* – Banamex protected the safer bonds. More specifically, a buyer of the AA- rated bond would be protected against 20 percent decline of the peso. This made the PLUS I notes even more

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[40] Ajustabonos are peso-denominated debt indexed to inflation. These bonds ceased to profitable since inflation eventually decreased to one digit by 1993.
[41] Partnoy, *Fiasco,* pp. 78-82.
[42] Danielle Robinson, "Cash-Hungry Latins Love Equity Derivatives," *Euromoney*, October, 1993.
[43] For the rating of the dollar-denominated bond Standard & Poor's required a huge fee and a disclaimer on the offering memorandum that the rating did not reflect currency fluctuation risk. Partnoy, *Fiasco,* pp. 80-4.

attractive for investors.[44] Also, the bad quality bond held by Banamex allowed this bank to receive money for the *ajustabonos* and to own these government debt instruments simultaneously. The 20 percent of the *ajustabonos* owned by Banamex represented equity of the Bermuda company; hence, Banamex was considered the owner of the offshore company. In accounting terms, all of the Bermuda company's assets and liabilities, including the *ajustabonos,* were part of Banamex.[45]

Another widely-used financial instrument linked to the Mexican peso was the total return swap. This instrument was mostly used to profit from interest differentials of a pegged currency in order to borrow in U.S. dollars and invest in Mexican pesos. A Mexican bank and a financial firm in Wall Street signed a contract that established that the Mexican bank would pay to the financial institution the 'loan,' and the latter would pay the bank the 'total return' on pre-selected securities. These securities were often short-term peso-denominated *cetes*.[46] In this operation, a Mexican bank agreed to pay the financial firm at LIBOR plus some additional points on a dollar loan for a short period of time. In exchange, the New York investment bank agreed to pay the Mexican bank the return on a given amount of *cetes* for the same period of time.[47] If the peso did not decrease in value against the U.S. dollars, the returns in the *cetes* remained high and the payment on the dollar loan stayed low. In this way, Mexican banks could borrow dollars from the Wall Street firm and receive the return from the Mexican bond. At the same

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[44] Peter Garber, "Post-Crisis Sovereign Risk Management Crisis," Paper presented at the *World Bank, International Monetary Fund, and Brookings Institute Conference Emerging Markets in the New Financial System: Managing Financial and Corporate Distress,* Washington, 2000: March 31-April 1.
[45] Partnoy, *Fiasco,* pp. 85-6.
[46] Peter Garber, "Derivatives in International Capital Flows," *National Bureau of Economic Research Working Papers Series, 6623,* Cambridge: NBER, 1998, pp. 8-10.
[47] Garber, "Derivatives in International Capital Flows," pp. 10-1.

time, the Wall Street firm will hedge their risk by buying *cetes* directly from this bond market.[48]

This financial instrument was particularly helpful for Mexican banks since credit limits and regulatory constraints established by the Mexican legislation did not allow banks to borrow U.S. dollars directly from abroad. In addition, total return swaps allowed Mexican banks to keep these transactions off-balance sheet. As a result, these operations were not subject to the eight percent capital requirement or to the 10 percent ceiling on foreign currency. An additional advantage of this instrument was the fact that they could not be thought of as taxable earnings since these swaps, including their profits, did not have to appear in the balance sheet.

Another type of derivative, linked to the value of the peso, was the equity swap. In this case, a Mexican bank, a Mexican company, or a Mexican national could sell the bank's or company's stock to the provider of the swap in exchange for U.S. dollars. The borrower would pay a floating rate – LIBOR plus a spread – on the notional principal amount and the Wall Street firm would give the borrower the total return on the stock. At maturity, the New York firm could sell the stock back to the borrower or liquidate it in the market. In this transaction, any appreciation of the stock above the price set between the two parties was paid by the Wall Street firm to the borrower. In the case that the stock price dropped below the set price, the borrower had to pay the difference to the firm.[49]

Like the *cetes* swap, the equity swap was helpful in taking advantage of the

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[48] Partnoy, *Fiasco,* pp. 185-6.
[49] See: Robinson, "Cash-Hungry Latins Love Equity Derivatives," pp. 34-5.

interest rate differentials between the United States and Mexico. With the equity swap, investors could avoid foreign currency restrictions and taxation since these equities were off-balance sheet items. Equity swaps, however, offered further benefits for owners of large portions of equity portfolio who wanted to obtain leverage and liquidity without selling their shares. This was especially the case of the investor that sat on the board of directors of a Mexican company. Likewise, a foreign investor could enjoy the returns from ownership without actually owning equity, thereby circumventing taxation on corporate holding and other restrictions placed on foreign investment. The OTC market for Mexican equity swaps started growing rapidly in the early 1990s.[50] By July 1993, Bankers' Trust had already issued several sets of equity swaps on the former state-owned phone company Teléfonos de México American depositary receipts (ADR), Apasco, a Mexican cement company, and ICA, a Mexican construction company.[51]

Mexican companies and banks not only preferred OTC transaction, so as to avoid Mexican regulations, but also their preference was determined by the low cost of obtaining dollar loans. For instance, Telmex and Bancomer raised U.S. dollars by issuing American Depositary Receipts (ADRs) in American capital markets. In spite of this, ADRs remained an expensive source of dollars. In addition, participation in U.S. financial markets made these Mexican companies vulnerable to taxation in the United States. By the early 1990s, several underwriters of good-quality issues had difficulty selling the ADRs because of an increase in the spreads over American government bonds and the yields offered by Mexican corporate issues, which were below the nine percent

[50] US investment banks such as Merrill Lynch and Bankers Trust were leading this market.
[51] Michael Murray, "Mexico Battles to Build Derivatives," *Euromoney*, July 1993, p. 88.

minimum required by institutional investors.[52] Consequently, derivatives became more attractive than any other financial instrument used to raise U.S. dollar funds.

In all these cases, derivatives, such as foreign exchange forwards and total return swaps, functioned to quicken the pace and deepen the impact of the1994 peso crisis in Mexico. Mexican banks held 16 billion dollars in *tesobono* total return swaps at the time of the devaluation of the Mexican peso. The initial peso devaluation depressed the value of *tesobonos* by 15 percent, and this would have required the delivery of 2.4 billion dollars in collateral on the next day. This accounted for approximately one half of the five billion dollars of foreign reserves lost by the Mexican central bank the day after devaluation. Collateral or margin calls on derivatives thus accelerated the pace of the Mexican peso crisis. The difficulty and the policy dilemma was not the shorting of the local currency, but rather the accumulation of large, off-balance sheet long positions – such as total return swaps – on local currency government securities.[53] In addition, Mexican banks had taken a large and unbalanced position in OTC derivatives markets that generated massive demands for liquidity. Further losses were created, leading to a lack of liquidity in the banking system.[54]

After the 1994 peso crisis, a sign of revival of derivatives operations linked to the peso is the increase of OTC operations. According to the Bank of International

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[52] Anonymous, "Finance: Falling in Love Again," p. 63.
[53] Peter Garber and Subir Lall, "Derivative Products in Exchange Rate Crisis," in Reuven Glick (ed.), *Managing Capital Flows and Exchange Rates: Perspectives from the Pacific Basin*, Cambridge: Cambridge University Press, 1998 quoted in Randall Dodd, "Derivatives: The Shape of International Capital Flows and the Virtues of Prudential Regulation," p. 12.
[54] Peter Garber, "Transition to a Functional Financial Net in Latin America," *Paper prepared for the Inter-American Development Bank Conference on Safe and Sound Financial Systems: What Works for Latin America*, Washington, September 27-28, 1996, p. 15.

Settlements (BIS), the notional amount of all outstanding derivatives stood at $535 billion by June of 2005. This trading of derivatives on the Mexican peso is directed mainly towards foreign exchange risk. "Such instruments account for 86% of OTC trading in Mexican pesos, compared to only 12% of worldwide activity."[55] The sophistication of the market, the BIS notes, is reflected in the increasing use of options and currency swaps in Mexican peso markets:

> The share of options in the notional amount of all instruments on the peso rose from 12% in June 2002 to more than 50% three years later. Currency swaps with one leg denominated in pesos hardly existed three years ago and have since become the most rapidly growing part of the peso derivatives market. During the first half of 2005, their notional amounts more than trebled to $53 billion.[56]

Derivatives have played a central role in the sudden growth of the Mexican economy in the onset, duration, and the aftermath of the peso crisis of 1994. This has been well acknowledged by state officials in Mexico and the United States despite derivatives' absence in official and academic debates. For instance, Alan Greenspan, Chairman of the U.S. Federal Reserve, recognised that there is a tendency of the new global financial system to make developing countries dependant on portfolio capital, and "recent losses on derivative instruments have helped to condition those markets."[57] Most importantly, the period between 1990 and 1994 in Mexican economic history raise interrogations regarding derivatives role in accumulation in Mexico in the context of capital internationalisation. Particularly, it shows that the importance of derivatives does

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[55] Christian Upper, "Derivatives Markets," *BIS Quarterly Review,* December 2005, p. 6.
[56] Ibid., p. 7.
[57] United States Congress Senate, Committee on Foreign Affairs, *Mexico's Economic Situation and US Efforts to Stabilize the Peso*, Hearing 26 January 1995, 104nd Congress, 1st session, Washington: Government Printing Office, 1995, p. 73.

not derive from their volume, but rather from their functions in bridging differences and disciplining capitalist social relations within the country.

Bridging Differences: Derivatives and the Power Bloc in the Mexican Economy

The burgeoning market for derivatives linked to the peso shows the profit opportunities offered by these transactions. However, the use of derivatives is not only limited in order to hedge risk and obtain short-term gains. Rather, derivatives have secured the integration of the Mexican economy to international accumulation while fragmenting capital and guaranteeing the crossing of capitals worldwide. The PLUS I illustrates how derivatives blend different fragments of capital originating from Mexico. *Ajustabonos*, and their denomination in pesos, represented the performance of the Mexican economy as a whole, primarily the performance of labour as consumers, workers and taxpayers. The measuring of the economy in the form of *ajustabonos* was separated into different investment packages in another currency. The PLUS I notes therefore fragmented the performance of government bonds into tradeable commodities.

The *cetes* and equity swaps make evident the ways in which derivatives bridge discontinuities in accumulation by preserving the worthiness of capital as it moves internationally. In this case, Mexican banks could profit from temporal and territorial differentials set by exchange and interest rate differences between Mexico and the United States. Mexican banks did not have to wait for the realisation of profits in their banking activities or their investment in *cetes*. Instead, Mexican banks and nationals could acquire U.S. dollars in the present and returns in their government assets in the future. In turn, this guaranteed the position of the banks in the international crossing of capitals

while preserving the value of their assets in pesos. Mexican banks could carry out international operations in dollars at different times without losing the worthiness of their peso assets. The contrary would be the case if banks decide to use the spot market to exchange pesos for dollars. More specifically, exchange rate differences in the spot market could have made the peso lose value and add uncertainty to the rate of conversion in economic transactions, obstructing the process of international accumulation.

These financial instruments were widely used before the peso crisis and show profound transformations in ownership and competition in Mexico. Profits could be made without actually owning the stock or the government asset. With the PLUS I notes, Banamex could own *ajustabonos,* and still trade the performance of the underlying asset. Likewise, the *cetes* and equities swaps allowed their owners to retain these assets in the balance sheets, and make the right to buy or sell the profitability of the underlying bond or equity a commodity with liquidity. The performance of a given asset, therefore, became separated from claims over future profits.

Since PLUS I notes, *cetes* and equity swaps were financial products offered by several investment banks to different investors, these derivatives competed against each other. As a result, different fragments of the Mexican economy or a productive process within Mexico were competing against each other through derivatives. Competition was no longer predominant among firms. Instead, different portions of a productive activity in the same firm competed against each other through an equity swap. Likewise, Mexican public debt, and hence fragments of the state finance and the Mexican economy,

competed against each other in the form of *cetes* swaps and PLUS I notes, making capital compete as capital.[58]

An understanding of the characteristics of financial derivatives in the context of the period prior to 1994 peso crisis is useful to understand the role of the Mexican power bloc in financial markets. Financial innovation in these instruments was closely linked to the needs of the financial sector within the power bloc. As such, derivatives were not homogenous instruments imposed on Mexican corporations by U.S. financial institutions or foreign investors. Rather, the Mexican power bloc was influential in the designing of these derivatives, and the profitability of their operations were partly ensured by the power bloc's influence over Mexican economic policy and the 'locking-in' of policies favourable to capital within NAFTA, the Mexican central bank independence, and the fixed exchange rate.

Likewise, the nature of the peso crisis was influenced by the Mexican power bloc. As Peter Garber argues, the notion that the 1994 peso crisis was a "triggering disturbance emanated autonomously from the world financial system is a myth, based on no supporting evidence." The attack on the peso, Garber notes, "was not sparked by the 25-year-old 'green-screen brigade' in New York, nor by panicked country fund managers, nor by a front-running Soros."[59] Garber notes that data on holdings of Mexican government securities and equities by foreign addresses show few negative movements in positions in the months before and after the collapse of the peso. It was the dominant

[58] Dick Bryan and Michael Rafferty, *Capitalism with Derivatives: A Political Economy of Financial Derivatives, Capital and Class*, London: Palgrave, 2006.
[59] Peter Garber, "Are Currency Crisis Self-Fulfilling? A Commentary," *NBER Macroeconomics Annual*, 11, 1996, p. 405.

sector within the power bloc, the large Mexican banks, that speculated on the peso in 1994, and therefore shaped the nature of this financial crisis.[60]

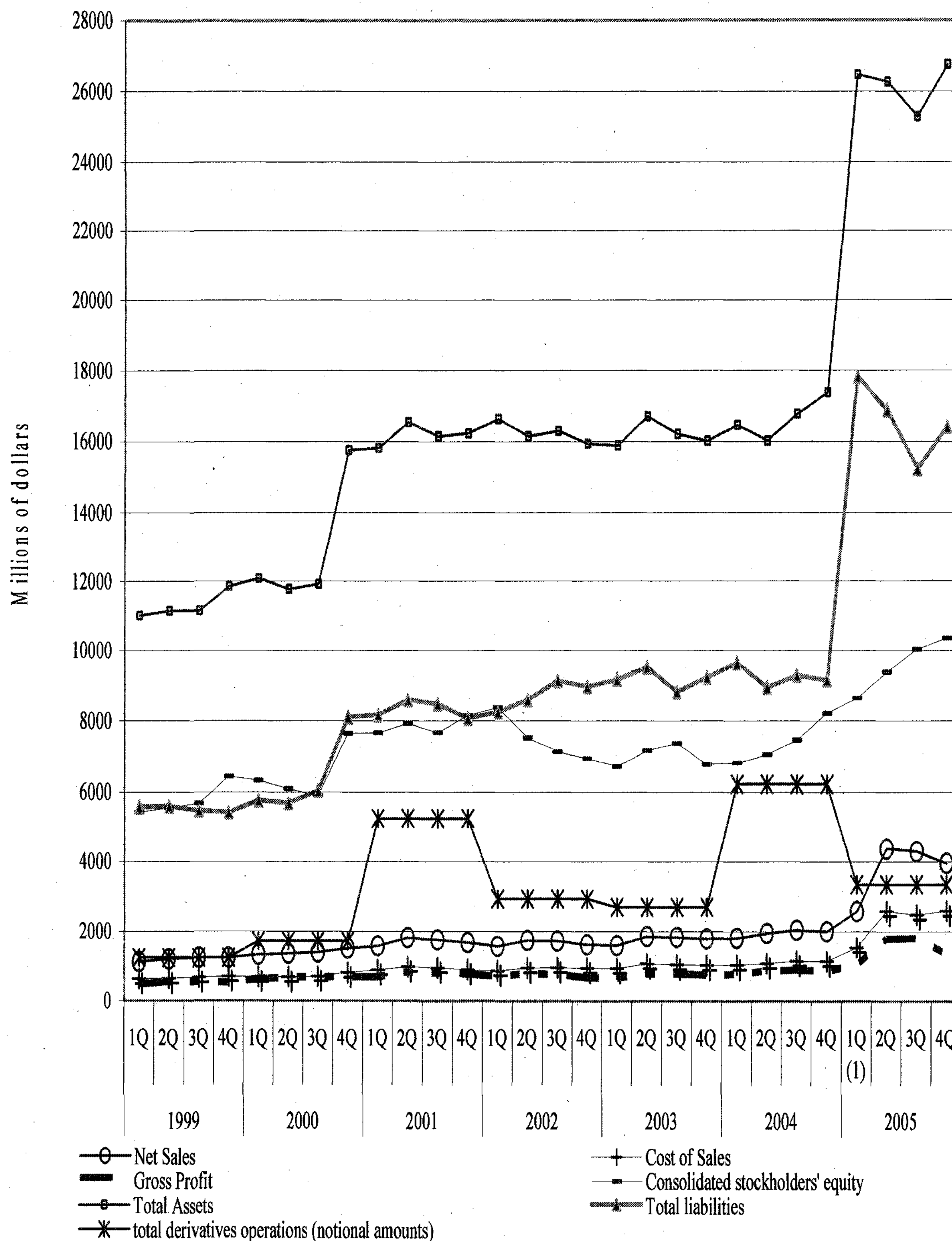
Firm Profitability, Derivatives and Labour in Mexico

Derivatives not only condition production in times of crisis, but they also operate as a pricing mechanism due to their character as money. A commodity may change hands once, but the futures or options contracts on that commodity are exchanged many times. This, in turn, has an impact on how the commodity's price is determined.[61] Derivatives can measure economic practices through global competition, and consequently set the criteria of profitability that capital has to achieve through labour productivity in order to have returns. They can drive productivity in terms of skilled labour, but also more working hours for fewer wages, and this becomes central to the neoliberal restructuring dynamics in Mexico in the era of derivatives.

For instance, CEMEX, a cement company with headquarters in Mexico and operations around the world, indicates in its 1997 Financial Report that its cement prices increased by five percent, and gross profits rose six percent, while production costs in Mexico, including labour and fuel costs, decreased by 10 percent.[62] CEMEX also includes in this report its participation in 120 million dollars' worth of equity swaps.[63] In subsequent financial reports, the firm shows that its sales are increasing, and the costs of production remain below the volume of sales. The difference between these two variables indicates the approximate gross profit of CEMEX's (See Figure 18).

[60] Garber, "Are Currency Crisis Self-Fulfilling? A Commentary," p. 405.
[61] Dick Bryan, "The Pass the Risk Trick," *Workers Online*, 75, 2000.
[62] Cementos Mexicanos, *1997 Fourth Quarter Results*, Mexico, 1997, pp. 6, 12.
[63] Ibid., pp. 9-10.

Figure 18. CEMEX's Financial Statement (millions of dollars)



Source: Based on CEMEX, *2000-2005 Annual Reports* and *Eight Year Financial Information* http://www.cemex.com/ic/ic_lp.asp. Retrieved 25 April 2007.

It is worth noting that stockholders' equity and the notional amount of derivatives contracts entered by the cement firm surpass both total sales and gross profits.[64] Still, difficulties arise when accounting for the percentage of profits from derivatives in the assets of this firm.

According to Mexican Generally Accepted Accounting Principles, derivatives can be classified as assets or liabilities depending on the gains or losses involved in these financial instruments.[65] CEMEX's indicator in its 2005 Annual Report, however, allows us to understand how derivatives hedge the company's position in different currencies and interest rates, while obtaining profits from derivatives operations.

> [CEMEX] incurred a U.S.$79 million foreign-exchange loss for the year, versus a loss of U.S.$24 million in 2004… This was more than offset by a gain on financial instruments of U.S.$386 million in 2005 compared with a gain of U.S.$120 million in 2004. This gain resulted mainly from cross-currency and interest-rate swaps and gains from our equity forwards, which were terminated during the third quarter. Majority interest net income for the year increased 62% to U.S.$2.11 billion as a result of strong operating performance, and gains resulting from our derivatives positions, such as the early termination of our equity-forward contracts in the third quarter of 2005.[66]

The contrast between production costs and CEMEX's financial obligations, particularly in the derivatives market, show that prices are not only determined by labour costs or supply and demand. Rather, the price of cement, and the pace of its production, depends on the firm's need to ensure the profitability of its equity to maintain gains in

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[64] For the purposes of this dissertation, the equity holders' indicator is important to measure the significance of derivatives in the performance of CEMEX. Equity indicators serve as an underlying asset in derivatives transactions, particularly equity swaps and options. Also, according to Mexican accounting standards prior to 2005, derivatives could be included in the stockholders' equity category when the fair value of an interest rate swap changes because of a shift from exchange floating to a fixed rate operation or when derivatives hedge the interest rate at which forecasted debt is expected to be contracted or renegotiated.

[65] Secretaria de Hacienda y Credito Público, *Ley del Impuesto Sobre la Renta*, art. 22.

[66] CEMEX, *2005 Annual Report*, p. 25.

derivatives contracts and covering its obligations in foreign currency at low interest rates. This availability of foreign currency at a predetermined price of conversion and low interest rates is necessary for the company's need to bridge discontinuities in its international operations.

In the CEMEX example, imperatives to reach the international norm of profitability influence the purchase of a derivative. The option to buy a derivative linked to a stock or government bond in a given currency in the future depends on the price of that stock or bond and the ability of the company or the Mexican economy as a whole to cope with market conditions. In this way, derivatives, as a pricing mechanism, discipline the conditions and locations in which money is put into the labour process and the terms under which the product of labour is turned into money again.[67] Derivatives reveal their class character through this disciplining effect on labour. This disciplining can take place through organisational changes in the production process to vary the volume of production according to market needs.[68] This includes changes in the wage patterns according to productivity, the capacity of the firm to hire and dismiss workers according to immediate production needs, the use of contractors for certain tasks, and payments for part-time work.[69] Still, the disciplining effect of derivatives requires the intervention of

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[67] Michael Rafferty and Dick Bryan, "Financial Derivatives and Value Theory: Towards a Theory of Capitalist Money," *University of Western Sidney, School of Economics and Finance , Working Paper Series Paper 2003/07*, November 2003, p. 23.

[68] Oscar Contreras, "Los estudios acerca de la Flexibilidad Laboral en México: Algunas Observaciones Críticas," *Estudios Sociológicos*, 54, 2000, p. 727.

[69] In the case of CEMEX, organisational changes have included just-in-time processes and thin provisioning as well. Maria de los Angeles Pozas, "Las Grandes Empresas Industriales en Mexico: Evolucion y Perspectivas a 10 Anos de su Reconversión," *Estudios Sociologicos*, 21: 2, 2003, p. 472.

the nation-state to set and enforce the conditions that secure profits and implement regulations.

Financial Crisis and the Mexican Territoriality of Derivatives

The role of derivatives in the Mexican economy depends on the nation-state to reproduce the state differentials of interest and exchange rates that drive financial markets and secure accumulation across political scales. State policies in Mexico have undoubtedly provided the opportunities for economic gains while creating discontinuities in the process of accumulation. In particular, the Mexican state interrupted the circulation of capital by imposing restrictions on foreign exchange within Mexico and obstructed the expansion of firms by creating the conditions for costly corporate borrowing and posing the possibility of devaluation. While these regulations appeared to impede accumulation, they were necessary for the Mexican state to maintain the quality of the peso.

The peso crisis also became the expression of the discontinuities posed by the territoriality of the state on capital accumulation. The peso crisis showed the inability of the Mexican state to mediate between policies that accelerated the circulation of total social capital internationally and the social structure that sustained these policies nationally. In the period prior to the crisis, the disciplining character of finance pressured the state to prevent investment and production from falling to levels that would put in jeopardy the social reproduction of capitalist social relations within Mexico. Conversely, the peso's worthiness needed to be sustained. This necessarily implied channelling resources and extracting more surplus value to maintain the value of the peso, thereby

threatening the social reproduction of capitalist relations. When the Mexican central bank could no longer sustain the value of the peso, the Mexican state also ceased to sustain temporarily the social structure that had permitted the former to use international reserves and direct public spending to manage the value of the peso at the expense of social programs, workers' wages, and high prices.

Instead of corroborating the regulatory void of the state in global financial markets, the 1994 peso crisis reinforced the fact that the Mexican state remains central to the operation of financial markets. The latter was necessary in order to maintain financial stability within the nation-state and restore the confidence of investors in the Mexican economy. The spatial dimension of the peso crisis manifested itself when collateral and margin calls began to be made and the Mexican state intervened with dollars and pesos to stabilise the financial system. This spatial dimension of the peso crisis shows how capital required the conversion of derivatives' debt obligations into a particular territorial currency in order to realise accumulation.

Whereas the global financial system traded and continues to trade the Mexican peso and peso-denominated assets beyond the national domains of the nation-state, the product of capital and labour, as well as means of debt repayment, remain denominated in Mexican pesos. The Mexican state was and continues to be responsible for the quality of its currency in order to sustain the continuity of global financial markets, particularly that dominated by the U.S. dollar, and international accumulation in general.

This was expressed by Robert Rubin, U.S. Secretary of Treasury in Clinton administration, in its statement before the American Congress hearing regarding U.S. financial assistance to Mexico after the peso crisis. Rubin stated that:

> [I]n the long run, though, I think there is something more fundamental involved, and that is the possibility that Mexico, which was the prototype for developing countries coming into the international financial markets in the last 5, 6 and 7 years, could, if this problem is not dealt with, change the mindset of international investors around the world and, thereby, cause a pull back from developing countries around the world and so result in economic, political, social, and security disruptions in those countries, which, in turn, could feed back and affect our vital economic and security interests.[70]

After the peso crisis, the Mexican state has obtained more money through the issuing of more public debt (Figure 19). [71] The latter has experienced an enormous growth not only in quantity, but also in the types of government notes investors can trade nationally and internationally.[72] For instance, JP Morgan, Merrill Lynch and Goldman Sachs and Co. created a bond, along with NAFINSA, the Mexican Development Bank, which is a note offering denominated in dollars.[73]

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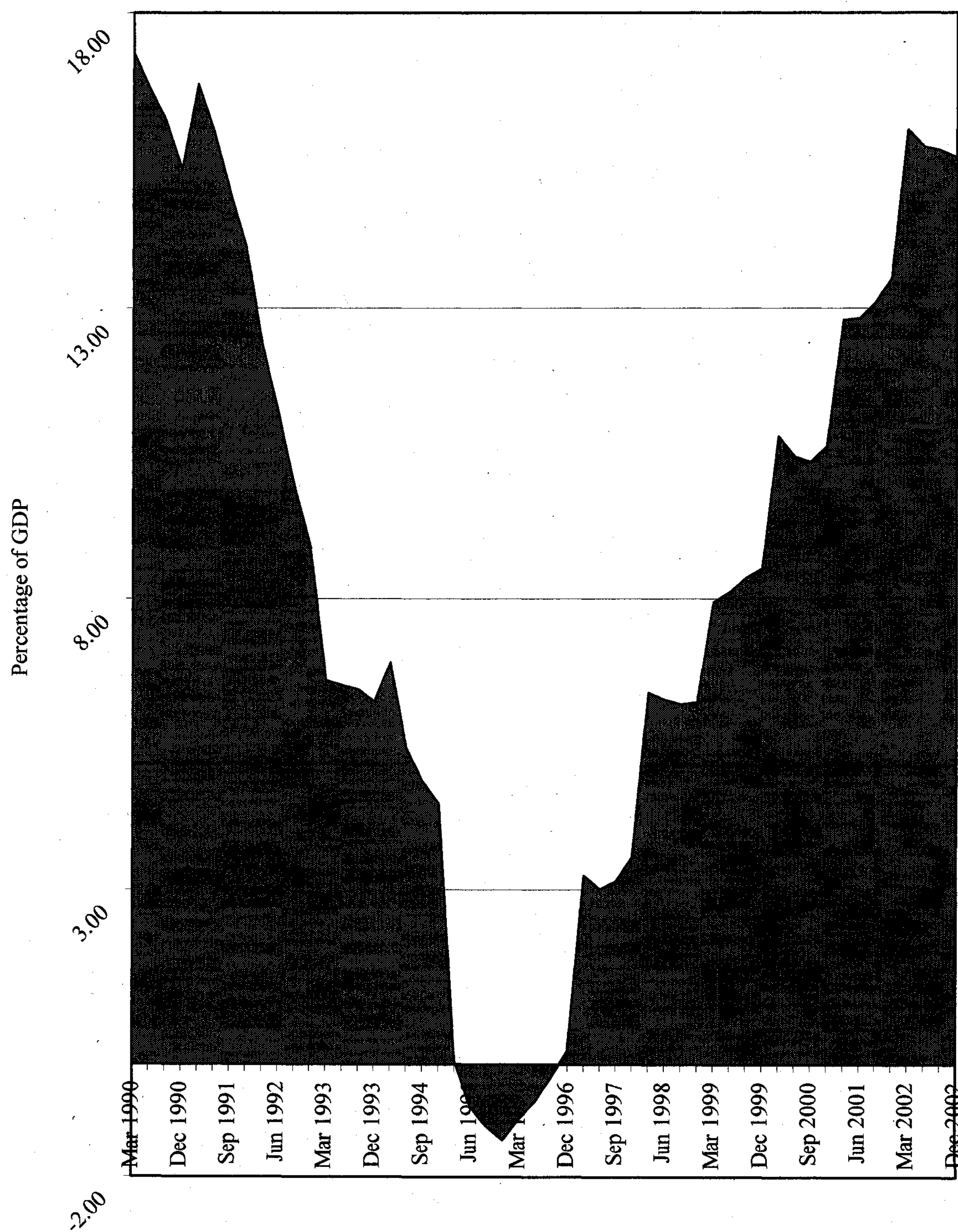
[70] United States Congress Senate, Committee on Foreign Relations, *Mexico's Economic Situation and US Efforts to Stabilize the Peso*, Hearing, 26 January 1995, 104nd Congress, 1st session, Washington: Government Printing Office, 1995, p. 60.

[71] The federal government, NAFINSA, PEMEX, the public-owned oil company, and Bancomext, the government bank for foreign trade, have continued issuing bonds in German, Japanese and American capital market. Banco de México, *Informe Sobre la Política Monetaria de México 1996*, Mexico, 1996, p. 126.

[72] The Ministry of Finance still plays a role in monetary policy since it provides authorisation to the operation of stock markets and banking institutions and plans government spending, including the needs and/or use of public debt. Alejandra Cabello, *Globalización y Liberalización Financiera y la Bolsa Mexicana de Valores*, Mexico: Plaza y Valdes, 1999, p. 176.

[73] JP Morgan's central role during the peso crisis has provided dividends to these firms. This is expressed in the operations this investment bank is undertaking in Mexico. "In Mexico, JP Morgan has topped the ranking of investment banks since 1885 for mergers and acquisitions, cross-border securitizations and underwriting public debt." Leslie Crawford, "JP Morgan Rides High After Mexican Comeback," *Financial Times*, 9 June 1998.

Figure 19. Mexico's Public Debt (percentage of GDP)



Source: Banco de Mexico, *Deuda Neta Total del Sector Público*, 2006.

Pemex has issued its own bonds in secondary markets and has received the highest credit-rating by Standard and Poor.[74] Some of the debt market operations of this public oil company have been carried out by First Boston.[75] The Mexican peso has also become the underlying currency of debt issued by organisations other than the Mexican state. In 2004, for instance, the Inter American Development Bank (IDB) issued its first ever bonds denominated in Mexican pesos. The IDB's Mexican peso bonds, besides the Brazilian *reais* denominated bonds, were the largest ever executed by an international issuer.[76]

Mexican monetary policy has assisted in restoring the continuity in accumulation through financial markets – for example, the assistance from the IMF and the U.S. government, the conversion of public peso debt into dollar-denominated debt, fiscal discipline, and high interest rates in public debt. Also, the Mexican state has been able to transform the tax system into a mechanism to transfer nationally-produced value abroad through the issuing of public debt in international markets.[77]

The Mexican state, therefore, has assisted the reproduction of derivatives trading in currency markets *via* state policies. This does not mean that Mexican state's policies towards promoting derivatives have imposed constraints on national policy. On the contrary, derivatives have become a new state mechanism to influence international markets in order to pursue a particular domestic agenda. The fact that national monetary

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[74] Victor Cardoso and Juan Antonio Zúñiga, "Autorizan a PEMEX colocar Deuda en BMV por 110 mil millones de pesos," *La Jornada*, 10 May 2005.
[75] Roberto Garduño and Enrique Mendez, "PEMEX se Endeudó por Más de 1 Billon para Financiar Pidiregas," *La Jornada*, 11 May 2005.
[76] "IADB Issues Global Bonds in Mexican Pesos," *Business News Americas*, 8 April 2004.
[77] Alfredo Saad Filho, "Currency Stabilisation under Conditions of Capital Mobility: The Case of Brazil," *Research Papers in International Business*, 13, 1998, p. 15.

policy affects the exchange rate of its own currency and the interest rates of the public bonds that circulates beyond its national jurisdiction suggests that policies of the nation state do transform the conditions of international mobility. The Mexican state has influenced the way in which capital is channelled into or away from certain markets to pursue a particular national policy and mediate the class struggle. First, the IDB Mexican peso bonds in international markets expand the Mexican state regulatory control beyond its national jurisdiction. The Mexican state can influence investment of these bonds through its monetary policy. Simultaneously, the sale of these bonds by the IDB facilitates the role of the Mexican state in preserving the value of its currency, since demand for the Mexican peso is relatively guaranteed by this international organisation. This is also the case of other government debt instruments in Mexican pesos that are traded as derivatives.

Second, the Mexican state has used derivatives to maintain the worthiness of the peso and guarantee resources for the state budget. In 1996, the Mexican authorities decided to auction put options of dollars on the last business day of each month, giving the right to credit institutions to sell dollars to the Mexican central bank on any day during the life of the contract, as long as the exercise price is no greater than the 20-day moving average of the fixed exchange rate. This exchange rate was used by credit institutions in Mexico to settle transactions denominated in foreign currency and to be liquidated within the country. This put options program, which was suspended in June

2001, allowed the central bank to accumulate international reserves to insure the floating of the peso against capital flight or sudden shocks to the capital account.[78]

Third, the Mexican state has employed derivatives in oil exports to secure the government's income. The central bank entered into futures, options, and swap contracts to ensure the export price of oil as it is established in the budget income. For instance, about 120 million barrels for delivery in the first half of 1991 were hedged through the sale of futures, purchase of put options, and taking the fixed-price side of short-term (up to one year) swaps. The hedges covered about half of Mexican exports. The central bank again hedged oil revenues to protect the state budget during the first quarter of 1993 by purchasing NYMEX put options. Both of these derivatives operations turned out to be profitable for Mexico, because crude oil prices fell sharply in the in those years.[79] Through derivatives, the state was able to guarantee a portion of the government's oil revenue to finance the budget.

The Mexican state has also been able to mediate the class conflict among firms by institutionalising derivatives within the country. Export-oriented industries were deeply affected by the policies of high interest rates, the peg of the peso and the subsequent peso devaluation of 1994 of the Salinas and Zedillo Administrations. The export-oriented sector was subjected to the interest rates demands of Mexican banks and suffered

[78] Manuel Galán Medina et al., "Una Estrategia de Acumulación de Reservas Mediante Opciones de Venta de Dólares, El Caso del Banco de México," *Banco de Mexico, Documento de Trabajo*, Mexico, 1996, pp. 1-5.
[79] Robert J. Weiner, "Managing Petroleum Fiscal Dependence, Lessons from Venezuela and Mexico," *The Center for Latin American Issue Working Papers*, 2000, pp. 23-4.

monetary losses in the post-crisis credit crunch.[80] This sector did not have access to a derivatives market to hedge risks; therefore, it did not profit from the increase in derivative operations prior to the 1994 peso crisis. For this reason, the Mexican state has sought to internalise the operation of financial derivatives within the Mexican economy under the regulation of the state. This has resulted in the opening of Mexico's derivative market (MexDer) in December 1999 in order to manage volatility while attracting funds to Mexican markets.[81] The creation of a formal derivative market in Mexico was also intended to allow Mexican enterprises to access derivatives within Mexico. Along the peso futures in Chicago, the MexDer has become the state strategy to allow these capitals to hedge risk and profit from differentials in financial markets. In fact, it is argued that MexDer was created in order to be more accessible to smaller investors. Thus, while in Chicago the peso contracts are in divisions of 500 000 pesos, the Mexican derivative market offers smaller sized contracts of approximately 150 000 pesos.[82] The formal market of derivatives still has a much smaller role since the MexDer derivatives were not established until recently and derivatives transactions continue to take place over-the-counter.[83]

The MexDer is then the expression of the Mexican state's temporary solution to the dilemma of meeting an international and domestic agenda in the accumulation process. This has been translated into policies directed towards allocating social capital in a way that would allow the Mexican state to manage spatial and temporal

[80] Mary Anastasia O'Grady, "Why Mexico's Nafta Boost Did not Last," *Wall Street Journal*, 22 October 2004.
[81] See: Banco de México, *Política Monetaria, Informe sobre el Primer Semestre 1999*, Mexico, 1999.
[82] Timna Tanners, "Mexican Futures Draw Near," *Business Mexico*, 1996, 6: 9, p. 16.
[83] Jonathan Wheatly, "How to Live with Risk and Volatility," *Latin Finance*, 137, 2002, p. 37.

uncertainties. The internalisation of derivatives within the Mexican nation-state, through the MexDer, attempts to act in response to sectors whose capital realisation and reproduction is conditioned nationally.

State Power, Scales, and Financial Discipline in Mexico

The functioning of derivatives linked to the peso and the reproduction of capitalist relations within the country has also relied on the state's reproduction of 'economic nationality,' on the one hand, and the securing of capital accumulation across multiple scales, on the other. Derivatives have made national accounting processes more complicated and dubious. The conventional understanding of national accounting considers a country's balance-of-payments records its international position, lending and borrowing. Each transaction is classified according to the payment or receipts that it generates. Under the conventional notion of balance-of-payment, international organisations such as the IMF as well as Mexican officials argued that Mexico was an attractive and reliable market for foreign investment, since 21.9 billion dollars of Mexican treasury certificates were owned by foreign investors at the end of 1993, compared to the 5.4 billion of foreign investment 1991.[84] According to this interpretation of the balance-of-payments, there was a high supply of foreign exchange to Mexico and a high demand for the peso.

This explanation is problematic since derivatives operations need little or no capital in terms of the Basle capital adequacy requirements and are classified as off-

[84] See: Craig Torres, "Mexico's Peso Begins to Show More Volatility," *Wall Street Journal*, 21 March 1994; María Cristina Penido de Freitas and Daniela Magalhães Prates, "La Experiencia de Apertura Financiera en Argentina, Brasil y México," *Revista de la CEPAL*, 70, 2000.

balance-sheet items. Advocates of off-balance sheet financing argue that derivatives cannot be seen as loans or deposits, and therefore should not be included in the balance sheet of a company or a bank. Within this view, loans are assets and deposits are liabilities in which the referential amount is fully paid on a loan by a borrower or on a deposit by a bank. Unlike loans and deposits, parties agree on exchange payments on some referential amount in derivative operations which is not fully paid. In this view, a derivative is not an asset or a liability, but rather an instrument used for risk purposes.[85] As a result, derivatives can be classified as assets or liabilities according to a firm's expediency as illustrated in the CEMEX example.

Derivatives, therefore, make considerations of foreign capital inflow in Mexico problematic since these financial instruments, as off-balance sheet operations or interchangeable items in a company's financial statement, can fabricate income or revenue, and debt can be hidden through the use of swaps. Restrictions are only applied to foreign exchange positions held 'on' the balance sheet. Since derivatives are often held off-balance sheet, they are not liable to these regulations, which was the case prior to the 1994 peso crisis. Also, the denomination of assets and liabilities can be changed with derivatives. For example, long-term loans can become short-term ones if put options are exercised.

In addition, the form of capital or the investment vehicle can be transformed with derivatives. For instance, total return swaps can make short-term dollar loans (liabilities) appear as a portfolio investment, which is reflected in CEMEX's financial statements.

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[85] Partnoy, *Infectious Greed*, pp. 44-6.

This is also the case of *cetes* and equity swaps. Before the peso crisis, *cetes* or equities seemed to be held by a foreign address, even though the Mexican counterpart received the government bond yield and bears the risk of holding these securities. In this way, foreign addresses appeared to be buying Mexican securities, and therefore were labelled as foreign investors when, in fact, they were lenders of short-term dollars and Mexican firms were holding the *cetes*', or the stock's risk.[86] According to Garber, this explains how most of the public debt issued by the Mexican state was held mostly by Mexican banks, companies, and nationals through derivatives despite its appearance as foreign investment in the balance of payments.[87]

In the case of the PLUS I notes, for instance, Banamex's off-shore company and the profits obtained from the issuing of these structured notes are considered part of 'national' domestic savings and a Mexican investment abroad. This is due to the fact that Banamex only retained 20 percent of the underlying assets of the PLUS I notes, which was not an investment *per se*, but a rather a potential loss, since this percentage was taken as a collateral.[88]

In this way, derivatives challenge notions of national balance-of-payments, particularly dichotomous conceptions of foreign and national capital. Still derivatives rely on the state's national construction of the economy and national policies in order to internalise the discipline of competition within the country. This internationalisation of capitalist discipline is carried out through the targeting of labour by the state as an

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[86] Garber, "Derivatives in International Capital Flows," p. 30.
[87] Peter Garber, "What you see versus What You Get," in Charles Adams, Robert E. Litan, and Michael Pomerleano (eds.), *Managing Financial and Corporate Distress, Lessons from Asia*, Washington: World Bank, IMF, Brookings Emerging Markets Series 2000, pp. 380-1.
[88] Partnoy, *Fiasco,* p. 81.

adjustment mechanism to accommodate national conditions to international accumulation. Derivatives contractual obligations have become a lien against present and future production, taxation, and exploitation of nature (in the case of oil exploitation by PEMEX). When derivatives obligations come due, production costs have to be reduced through wages and job cuts, real goods have to be produced and sold, and taxes have to be collected to make interest and principal payments.[89] In turn, state intervention to enforce discipline over labour and construct an 'imagined' national economy is required. This was particularly evident in the state's role after the peso crisis. The Zedillo Administration implemented an austerity plan, and this plan's main policy target was labour. This plan included a 10 percent reduction in public expenditure, particular social spending, and tight wage restraints, which consisted of a 10 percent wage increase in a context of inflation forecasts of 42 percent.[90] Also, the plan imposed higher energy prices in order to decrease demand and reduce government subsidies.[91] These measures were justified under the premise that national competitiveness and the balance-of-payments needed to be improved. This was expressed in Zedillo's Plan of Economic Emergency of 1995, in which he states that "[Mexico's] critical circumstances will impose sacrifices for everyone."[92] As such, policies of austerity were based on a national construction of the economy.

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[89] Peter Bell and Harry Cleaver, "Marx's Theory as a Theory of Class Struggle," *Research in Political Economy,* 5, 1982, p. 252.
[90] "Mexico: Shock Therapy," *Oxford Analytica*, 3 March 1995, p. 1.
[91] Dianne Solis, Craig Torres, David Wessel, "Markets Gain on Austerity Plan," *Wall Street Journal*, 13 March 1995.
[92] Presidencia de la República, "Plan de Emergencia Económica," *El Mercado de Valores*, 2, 1995, p. 6.

The intensification of pressures of labour has been facilitated by the rescaling of state's economic governance. NAFTA has increased labour competition among countries while providing an infrastructural and regulatory framework that protects investment within the North American region. In this way, conditions of profitability set by derivatives can be achieved by firms that operate within NAFTA. Concurrently, policies of local and regional development intensify the process of competition for investment based on low-wages, skilled labour, and favourable infrastructural conditions among regions within the nation-state.

In this context, competitive pressures on localities have been further deepened by the decentralisation and securitisation of local governments' spending. Previously, the only source of funding for local states was traditional bank lending, provided either by development or commercial banks. The enactment of the Fiscal Coordination Law was critical in providing the Mexican states and municipalities with access to capital markets. According to the Mexican Constitution (Article 117 for states and Article 115 for municipalities) and to the Fiscal Coordination Law (Article 9), tax participations can be used as a guarantee for the issuance of debt instruments. This can be used to fund infrastructure projects with the authorisation of the local legislatures – the states' congresses and the municipal councils. In the year 2000, the federal government approved the development of a trust that regulated and established payment procedures for debt issuance guaranteed by tax participations.[93] In this way, some Mexican municipalities such as Monterrey, Tlaneplantla, and Aguascalientes have started issuing

[93] Maria Tapia and Juan Pablo De Modellein, "Mexico's Subnational Securitisation Market Entering Second Stage of Development," *Standard and Poors Ratings Direct,* 2004.

debt backed by federal tax participations.[94] This was also favoured by increases in the section 33 of the federal budget, which provides the expansion of funding for municipalities. Such debt issuances are secured by tax revenues collected by the Mexican federal government and redistributed to the states and municipalities through the federal revenue-sharing system.[95]

As a result, the Mexican state and local governments have aimed at the creation of local financial markets by granting local governments' access to international capital through sub-sovereign debt. In this way, not only is the national economy subjected to capitalist calculation, but also the very performance of small localities can be directly measured by the international measurability set by financial markets. This, in turn, often takes the form of grades given by international rating agencies such as Standard and Poors and Moody's. Like the imperatives of regional development, the process of securitisation towards more local political scales of economic governance also compels states and municipalities to intensify the process of competition in order to attract more investment and increase their share of federal transfers in order to service local bonds.

The construction an 'imagined' national economy is not without policy consequences. Such construction is necessary to create national state policies that make labour bear the costs of derivatives' profits. The tightening of the relationship between the peso value and inflation rates through the *corto* and inflation targeting has reinforced

[94] Summit Thakur, "Municipal Fund Global Finance for Local Needs," *Paper presented at the Second International Conference on Municipalities and Sub-National Governments*, Washington, 1 October 2004.
[95] See: Standard and Poors, *Local and Regional Government*, New York: McGraw Hill, 2002; Smith Barney Equity Research, "Local Debt Markets and Official Agencies Enhancing Growth Opportunities," *Paper presented at the World Economic Forum Conference, Leveraging Official Sector Capital and Enhancing Financial Governance,* Sao Paulo, 26-27 October 2004.

even more the role of labour as an adjustment mechanism. This has further secured the profitability of derivatives. In other words, the fact that exchange rates and inflation targets do not have to accommodate productivity and labour needs guarantees that derivatives' profitability is not affected by social demands.

The National Bank of Foreign Trade (Banco Nacional de Comercio Exterior, or Bancomext), for instance, has expressed that the national competitiveness of Mexican goods is no longer related the peso exchange rate. Instead, "the competitiveness of the Mexican private sector is more directly related to the intensification of productivity."[96] The Mexican state's targeting of labour as the only national adjustment mechanism, and the way financial markets, particularly derivatives, have made labour costs the source of profits have also been expressed by Mexico's former Finance Minister in Fox's administration, Francisco Gil Díaz and former IMF Deputy Managing Director and Finance Minister in Calderón's presidency, Agustín Carstens:

> [I]n an open economy, the one factor of production whose cost may become misaligned with the rest of the world is labour. Credit may be costlier in a developing country, but its higher cost cannot be compensated by moving the real exchange rate. Technology can be readily assimilated from whatever source, specially embodied as foreign investment... But the domestic cost of labour can get out of line. It can do so because of any of an array of' several possibilities, such as increased unionization, increased union aggressiveness, false business-labour-wage-contracting which anticipated higher than realized inflation, or backward wage-price indexation, etc... Firms do not pay tuitions, nor household rents, nor buy hamburgers in order to compete. They pay for labour and other inputs and the use of other measurements of the trend in relative competitiveness is warranted (but misleading) only when information is unavailable to compare unitary labour costs.[97]

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[96] Bancomext is a public development bank that funds and promotes Mexican exports. Anonymous, "Dejan de Supediatrse al Tipo de Cambio los Exportadores," *El Universal*, 28 March 2000.

[97] Gil Diaz and Carstens, "Some Hypotheses Related to the Mexican 1994-95 Crisis," pp. 16-7. Such a view has been reflected in the stagnation of salaries during the Fox administration. Between 2001 and

Derivatives evaluate the costs of Mexican labour in relation to other countries. Still, the conditions to foster this productivity in Mexico can only be set by the Mexican state through the flexibilisation of labour regulations, cooptation, or repression of unions and downward pressure on wages *via* monetary policy. In the words of Gil Díaz and Carstens, these state measures prevent domestic cost of labour 'to get out of line,' and diminish the private sectors' profits in order to secure neoliberal discipline in the country.

Conclusion

Several analyses have interpreted the 1994 peso crisis as the result of declining state power in relation to the mobility of capital. Alternatively, this chapter has shown that it is within the nation-state that the instabilities of global finance appear. It is there that they are temporarily resolved, mediated and reproduced. The peso crisis of 1994 also expressed a fundamental contradiction between capital accumulation and the nation-state – namely, the attempt of the Mexican nation state to regulate a process that is inherently international. These territorial differentials are therefore not external to capitalism, but rather internal to the process of accumulation. They are the specific organisation of space that capitalism necessitates to "annihilate space through time" in financial markets. Likewise, derivatives are not peripheral elements of the circuit of capital that only cause speculation. Rather, they have become a new form of commodity money that is inherent to capitalism in order to discipline labour within Mexico in the context of neoliberal restructuring. An analysis of both spatial differences and the territoriality of derivatives show that global financial markets do not eradicate nationally-

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2006, real wages fell 22 percent. Patricia Muñoz Ríos, "El Poder Adquisitivo del Salario Mínimo Cayó 22% en el Sexenio de Fox," *La Jornada*, 6 November 2006.

determined differences expressed in the Mexican nation-state, but rather reproduce them. The disciplining character of derivatives can only be expressed through the neoliberal financial and legal institutions of the Mexican state, and they are there to secure and reproduce the capital relation at complex political scales of governance.

Part 5 Conclusion

Chapter 10

Financial Discipline, Space/ Scale, and the Limits of Mexican Democracy

Mexico has experienced a series of contrasting developments in the last decade. While poverty has increased and labour conditions have continued to deteriorate, forecasts of the financial profitability of the Mexican economy remain optimistic and financial derivatives linked to the Mexican peso continue to be a profitable business for both Mexican and international investors. This has taken place in a context of liberalisation of the electoral process, increasing plurality of political parties in Congress from 1995 onwards, and the victory of the PAN in the presidential elections of 2000 and 2006 – the so-called Mexican democratic transition.

These political transformations have intensified the debate regarding the policies that the Mexican state has to adopt to deal with the internationalisation of the economy. A strong position towards further internationalisation of the Mexican economy is comprised in the Security and Prosperity Partnership of North America (SPP). The SPP has stated that further collaboration among North American countries is necessary to increase productivity and minimise the effects of territorial boundaries over economic flows. The SPP 'prosperity' agenda expresses that:

> [The SPP] must work towards the freer flow of capital and the efficient provision of financial services throughout North America (e.g., facilitate cross-border electronic access to stock exchanges without compromising investor protection, further collaboration on training programs for bank, insurance and securities regulators and supervisors, seek ways to improve convenience and cost of insurance coverage for carriers engaged in cross border commerce).[1]

[1] White House, Office of the Press Secretary, *Prosperity Agenda: Promoting Growth, Competitiveness and Quality of Life,* Washington, 23 March 2005.

Indeed, the SPP recognises the importance of the state in providing a framework that creates competitive conditions for businesses while securing national borders.[2] Still, the role of the American, Canadian, and the Mexican three states is depicted in economic rationalistic terms. The role of these states, particularly the Mexican state, is confined to facilitating economic transactions and providing investors with security and protection for their investment in the region. As such, states in the North American region are only required to provide the institutional framework that fosters market mechanisms and safeguards private property.

A reformist agenda has also emerged as a dominant paradigm in Mexico. It is clear that current Mexican president Felipe Calderón (2006-12) agreed on Mexico's participation in the SPP and based his electoral campaign on ideas from the right, particularly on the importance of markets in regulating Mexico's economic life. However, Calderón's campaign gradually moved towards a more moderate discourse. Calderón claimed that he was going to *rebasar a la izquierda por la izquierda* or 'overtake on the left.' This meant he was going to implement his PRD opponent Andrés López Obrador's proposals while maintaining a strict economic policy.[3] Once elected president, Calderón's position was more clearly stated during the World Economic Forum 2007 at Davos. The Mexican president stressed the need for balance between the private and public sectors: "The market is a necessary, but not sufficient, condition… The state is needed to make corrections. We have to build from the centre a regime that

[2] Security and Prosperity Partnership of North America, *Joint Statement by President Bush, President Fox and Prime Minister Martin,* Texas, 23 March 2005.
[3] Days after taking office, Calderón took similar measures proposed by López Obrador. He announced he would slash his salary, and those of his top officials, by 10 percent and put the savings toward social programs.

respects the market and a regime that pursues social justice and defends the environment."[4]

This reformist agenda was previously addressed by Jorge Castañeda in the early nineties, when he designed, alongside Roberto Mangabeira Unger, a common agenda that would break with both the neoliberal policies of the 'Washington consensus' and state populism. Castañeda's view emphasised the co-existence of market policies with social policies and democratisation of the electoral process. Castañeda, who was Minister of Foreign Affairs during the Fox Administration, said in regards to Fox's social policies that:

> [W]hile the continuity with Zedillo's policies as such is not compatible with Fox's social agenda, that agenda, I believe, is compatible with a broadly defined market paradigm, which I do not particularly like but I have to accept along everybody else because it is a fact of life today in most of Latin America.[5]

In general, this view relies on neo-Weberian assumptions that consider slow growth and increasing poverty as the result of the lack of adaptation of states to markets and the absence of technological innovation. For this reason, the perspective advocates collaboration between these entities, the formulation of policies that foster competitiveness, and the management of financial imbalances to maintain economic stability.

Critics from the left, in contrast, have blamed the negative effects of global accumulation on the decline of the Mexican state, the impositions of international financial institutions and the American state, and mobile financial capital. Still, the left

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[4] Presidencia de la República, *Conferencia de Prensa que Ofreció el Presidente de los Estados Unidos Mexicanos en la Ciudad de Davos, Suiza,*" Davos, 26 January 2007.
[5] Jorge Castañeda, "Mexico: Permutting Power," *New Left Review*, 7, 2001, p. 32.

in Mexico remains oscillating between support for Andréz Manuel López Obrador, the PRD presidential candidate in the 2006 elections, and the Zapatista Army of National Liberation (Ejercito Zapatista de Liberación Nacional, or EZLN). On the one hand, the López Obrador campaign was based on the idea *por el bien de todos, los pobres primero* or "for the good of all, the poor first." Along these lines, López Obrador pledged to provide a stipend to the elderly and healthcare for the poor, and break up the corrupt economic relationship that exists between the business class and the government. Still, Obrador promised to continue the implementation of macro-economic policies of price stability.[6] The EZLN, on the other hand, announced the beginning of *la otra campaña* or "the other campaign" at the end of 2005. "The Other Campaign" was an attempt to mobilise indigenous communities and workers to abandon Mexican state and partisan politics.[7]

The different debates that prevail in Mexico and their policy proposals have several limitations in proposing alternatives that can expand economic and political rights at the national level. The economic rationalist position comprised in the SPP further conceals and strengthens the power relations that reproduce neoliberalism in Mexico. The neo-Weberian perspective (or the Mexican 'third way') enforces the idea that financial deregulation is inevitable and apolitical by confining the explanation of financial globalisation to technological developments, organisational matters, and state cooperation with markets. This, in turn, leaves unproblematised the power relations and

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[6] Roberto Gonzalez Amador, "Candidatos Presidenciales en América Latina coinciden en Posturas Económicas," *La Jornada*, 15 January, 2006.
[7] Ejercito Zapatista de Liberacion Nacional, *Relatoría de la Primera Sesión Plenaria de la Otra Campaña,* Caracol de La Garrucha, 17-18 September 2005.

the role of the state in the construction of global markets, further concealing the relations of domination in Mexico.

Critics from the left, in contrast, have offered substantial contributions to the assessment of the negative effects of neoliberalism and globalisation in Mexico. While the Mexican left is gaining a measure of mobilisational capacity and rebelling, it lacks both an alternate organisation and programme beyond the modest reforms of Obrador and the autonomous communities of the EZLN, which are marginal to the national majority. The lack of an alternative programme is partly due to the absence of an analysis of the contradictory relationship between the territoriality of the Mexican state and the politics of money. Finance is only conceived as unproductive speculation or the loans and conditionalities of the IMF and the American state. The complexity of finance and its functioning, therefore, becomes subordinated to how speculation can be controlled and how the power of international organisations and the American state can be deterred. By looking at finance as a homogenous force that is speculative, or as conditional loans of the IMF and the United States, the critics of the internationalisation of the Mexican economy neglect the complex ways in which finance is articulated to the Mexican state, particularly through monetary policy. Questions of how finance and production are changing within Mexico are necessary to understanding the forms of power within Mexico and seeking alternative policies at the national level to the current economic agenda.

Blanca Ramírez Velázquez considers that the ways in which internationalisation has been depicted tend to ignore the territorial dimension of capitalism. When capital

internationalisation is explained as inevitable phenomena, Ramírez Velázquez contends, "any analysis of concrete tendencies that sustain the development of the 'economy-territory' relationship" is overlooked.[8] As a result, it remains unclear who implements and how internationalisation is implemented within concrete territories, particularly the nation-state.[9]

In the three perspectives, issues of state politics and finance in the context of capital internationalisation continue to be considered as separate realms. The articulation of state and finance, however, remains pivotal to understand the transformations of capitalist social relations in Mexico and their integration into the global economy. It is through the state that the dynamics of financial markets and neoliberal policies are reproduced. This is particularly evident in monetary policies which become mechanisms and political strategies of market discipline. In order to understand the 'economy-territory' relationship, this study has focused on the connections between the state and international accumulation in the form of finance. This articulation is understood through the territoriality of the Mexican state. Such an explanation is central for seeking new spaces of struggle within the state rather than outside of it, and to challenge the Mexican class structure, particularly the internal bourgeoisie, in its articulation to the Mexican state and international capital.

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[8] Blanca Ramírez Velázquez, "¿Integración o Subsunción? Globalización o Escalas en el Análisis Territorial: El Inicio de un Debate," en Elsa Patiño Tovar y Jaime Castillo Palma (eds.). *Globalización y Reestructuración Territorial*, Puebla: Programa Editorial de la Red de Investigación Urbana, 1999, p. 51
[9] Ibid., p. 52.

Space, State, and Finance in Mexico

In this dissertation, I have argued that the financial system integrates different aspects of the circuit of capital internationally and speeds up the process of capital circulation by advancing capital before it is realised. Finance is considered to be internal to the circuit of capital and is the form that social relations take. In the circuit of social capital, finance attempts to overcome space by advancing the non-realised surplus of labour. In this way, finance, as Marx argues, attempts to "annihilate space through time." Marx's insights reassert the importance of territoriality for capitalism's reproduction. In other words, the annihilation of space refers to the need of capital to territorialise itself in order to produce surplus value and realise profits. Also, capital necessitates the constant reconfiguration of space to provide favourable conditions to the continuation of the circuit. This spatial dimension of capitalism then points out that internationalisation relies on the territorial expansion of the capital relation embedded in production worldwide.

Space, however, can only be reconfigured *via* state policies and through the restructuring of the state apparatus. The state, in this way, is essential to the political reproduction of classes and the production of spaces for capital. The intensification of the internationalisation of capital has also required further restructuring of space and the state in order to remove democratic accountability from issues of economic management. This is of considerable importance to the reproduction of finance and capital's profitability internationally. This approach shows that the internationality of capital and the mobility of finance are not in dualistic opposition to the fixity of the state. Rather,

they have a dialectical relationship: the movement of capital relies on the relative fixity of the state to secure national conditions compatible with international accumulation.

The claims made by this alternative framework have been substantiated through an examination of three key aspects of Mexican political economy between 1982 and 2006. These three aspects are the articulation of the Mexican economy to the global economy and the restructuring of the Mexican state; the national scale of the Mexican state and its rescaling through NAFTA and political decentralisation; and financial disciplining through the extension of financial derivative markets in Mexico. These empirical analyses have demonstrated that processes of state reform, finance and territoriality are interrelated, and these offer a new and alternative means of interpreting and assessing policy developments in Mexico and its position within the global economy.

The first analysis, the articulation of the Mexican economy to international accumulation and the transformations in the state apparatus, shows the relationship between the Mexican nation-state and accumulation. The Mexican state set the conditions that fostered the sophistication of financial markets in the period prior to the debt crisis of 1982. Finance was not peripheral to the implementation of the import-substitution model in Mexico, but rather was intrinsically tied to industrial development and securitisation of state financing prior to the debt crisis. The securitisation of state finance and the favourable legal framework granted to the internal bourgeoisie to reproduce nationally and internationally, particularly Mexican banks, created the internal contradictions that conditions gave rise to the 1982 Mexican debt crisis.

The class configuration in Mexico, particularly the internal bourgeoisie, was pivotal in pushing for policies that endowed this class with opportunities to profit from interest rates and exchange rate differentials at the onset of the debt crisis. Yet, these policies were harmful to labour, and for this reason state policies were directed to mediating class struggle by devising government social programs that fragmented corporatism within the PRI. The debt crisis of 1982 also became a 'blessing in disguise' for the development of financial markets. This event set the conditions that allowed for the further sophistication of finance – the fragmentation of sovereign debt – and to the neoliberal restructuring of the state. The period of De la Madrid's and Salinas' presidencies show the early stages of the implementation of neoliberalism in Mexico. However, this is not merely conceived as changes in political discourse or the downsizing of the state, but rather neoliberalism is seen as the political construction of market discipline through the Mexican state. More specifically, the Mexican state removed old mechanisms of social participation and set the legal framework that enforced the discipline of the market in the country.

Because of the rising politisation of economic policies after the 1982 debt crisis, the traditional organisation of the Mexican state apparatus was dismantled. Such a traditional mechanism of economic decision-making, which was mainly articulated through the corporatist structure of the PRI, was replaced by its reorganisation into autonomous and rules-based institutions. This is expressed in the independence of the Mexican central bank, which has isolated itself from the negative effects of anti-inflationary policies through its institutional autonomy. This allowed the Mexican state

to deny responsibility and accountability for its monetary policy, while simultaneously enabling the central bank to retain a degree of control over economic policy and accumulation within Mexico. As a result, the autonomy of central banking and its rules-based approach to economic policy have become a 'depoliticised' governing strategy. Within this governing strategy, anti-inflationary policies and austerity that target labour and wages seem to appear to be externally imposed by the market. This has been particularly evident in the BANXICO's use of the 'short' and inflation targeting as key mechanisms to decrease inflation and sustain the value of the peso while increasing interest rates. This mechanism still relies on lowering wages in relation to prices. Overall, depoliticisation has imposed discipline on the national economy and insulated the state from adverse political and social consequences of anti-inflationary policies and neoliberal restructuring.

The politics of scale of the Mexican state, the second analysis undertaken in this thesis, illustrates capitalism's need to reconfigure space and produce representations of space to further depoliticise policy-making, intensify competition and contain class struggle. The politics of scale refers to the strategies of social groups to extend or intensify their control over people and resources by creating sociospatial configurations. In this process, state governance, as a site of class struggle can be rescaled, since it is through the state that socio-spatial configurations are institutionalised.

By looking more closely at the rescaling of the Mexican state, NAFTA ceases to appear either as an institutionally cosmopolitan and adequate form of market governance, or as the direct expression of the dominance of the American state over the Mexican

economy. Rather, the re-scaling of the Mexican socio-economic space can be understood as the extension of the Mexican state's control, along with the Canadian and the American states, over a wider set of social relations. NAFTA has also 'locked-in' investors' rights and neoliberal policies, reinforced the fetishism of the decision-making process, and isolated regional clauses and policies from societal pressures.

The process of decentralisation of government spending and policies of 'regional development' does not operate in opposition to NAFTA. Indeed, the local level and decentralisation have often been considered to be more democratic spaces of participation in economic policy and public budget distribution. However, the way in which the state has been re-scaled downwards in Mexico has served as a disciplinary mechanism. Policies of regional development have compelled localities to compete with each other for investment within Mexico and across North America while containing class conflict at the local level. At the same time, the restructuring of local spaces of governance have served to create a 'structural conherence' of infrastructure and production networks across North America. These simultaneously fragmented and integrating forms of local re-scaling have imposed market discipline more rigorously on workers, peasant communities, and the environment. This is well illustrated by the Plan Puebla Panama in Southern Mexico and the Burgos Gas Basin in Northeast Mexico. Policies of regional development have sought to reinvigorate Northern Mexico's economy through the energy industry and integrate the peoples' and ecologies of Southern Mexico into the market *via maquiladoras*, biotechnology, tourism and infrastructural development.

In order to co-ordinate upward and downward scales of economic governance, the national level of the state remains an integral field of politics and economics. The Mexican nation-state has in fact established the framework to constitute and organise these forms of governance. The Mexican state has constituted the spatial imaginary of the 'economic national' identity that conceals the power relations behind economic policy-making. This is particularly evident in the Mexican balance-of-payments. The Mexican economy is portrayed as a 'shared national experience,' particularly in times of crises and austerity. This spatial imaginary remains powerful in constructing policies that favour capital, marginalise labour, and re-construct the political basis for policies of productivity and 'national competitiveness,' which have tended to increase in the length of work-time and decrease the real wages of workers in Mexico.

The third component of analysis of the Mexican state was on the disciplining role of financial derivatives in Mexico. This analysis points to the ways in which international accumulation and state territoriality intersect at different scales, providing the conditions for the existence of the new money commodity of financial derivatives. Derivatives bridge differences within the circuit of capital, taking out the risk of holding one specific currency. Derivatives also reveal their character as social power since they determine how, when, and what is channelled into production or into financial activities in the country.

Derivatives have facilitated the rise in transactions of debt and assets linked to the peso. Prior to the peso crisis, several instruments such as *cetes* and equity swaps allowed corporations to sustain the value of their investment as money moved between Mexico

and other countries. While derivatives are usually considered as risk-management instruments, the peso crisis of 1994 shows that this is not the case. The greater leverage of derivatives multiplied the claims on peso debt, intensifying the loss of the central bank's reserves. More importantly, these financial instruments have become the means to validate the productivity of Mexican labour internationally, which has, in turn, intensified capitalist competition. Through derivatives, capital does not compete as firms, but rather as fragments of capital. This places emphasis on labour as the mechanism of adjustment of the Mexican economy to international conditions: it is labour markets and workers that bear the market imperfections to adapt to the requirements of stable exchange rates, profitable interest rates, and competitive labour prices.

While assets denominated in pesos could be considered highly mobile, these financial assets still rely on the territoriality of the Mexican nation-state. The Mexican state has remained responsible for the peso and for the policies that make peso investments attractive. High interest rates in peso deposits, a stable peso, and the state's guarantee of the means of payment emphasise the importance of the territoriality of the state in creating the geographical differentials that drive global financial markets. This has been particularly evident in the 1994 peso crisis, when the Mexican state had to secure the means of payments for derivative transactions. Derivatives have also become a new space of regulation to pursue a particular domestic policy and aid the disciplining of Mexican labour. This can be seen in the state's support of the Mexican derivatives market and the Mexican state's participation in oil derivatives to guarantee the state

budget. As such, the disciplining character of derivatives goes beyond the decisions of firms to change locations of production and cut wages and jobs. These decisions can only be sustained through state polices of regionalisation, local development and 'national competitiveness,' which undermine the capacity of workers to oppose deteriorating labour conditions and low wages.

From Theory to Political Practice

An explanation of the specific functioning of international finance, particularly financial derivatives, in its relation to state territoriality allows for an understanding of the ways in which such processes are related to production, state policy, and the measuring of value. This is particularly important in order to question competitive pressures on labour and demystify state policies that emanate from the politics of money. It is necessary to emphasise that the production process, far from being a separate sphere, is intrinsically tied to global finance. Firms have become increasingly finance-oriented through their stocks and portfolio investment in financial derivatives even if they are only engaged in production processes. In this context, a myriad of market participants, who are tied through the derivatives market, exert competitive pressures on productive activities and state debt performance. An explanation of the financial orientation of firms provides a basis for questioning deteriorating working conditions and pressures on productivity levels when firms and the Mexican state blame low returns and a lack of competitiveness on workers' performance. In other words, issues can be raised regarding the company's strategies and the state policies that allow a given company's financial

activities to receive a greater share of the profits in relation to workers' wages and the ways in which finance imposes direct competitive pressures on workers.

This financial orientation of firms, and its resulting competitive pressures, has become part of the agenda of the Mexican state *via* policies that hold exchange rates up and inflation rates down through interest rates, and promote national competitiveness. Inflation and competitiveness are seen as an apolitical and inevitable national economic need that depends on keeping workers wage demands low and productivity high. The problematisation of inflation and competitiveness allow us to question why there is such a focus on fighting inflation to the exclusion of employment and wage when inflation does not come from workers' wages, but rather from the liquidity added by the financial system, including state debt and derivatives. By raising this question, the relationship between finance, monetary policy, and economic competitiveness at the regional, national and local scales *via* monetary policy can be exposed as a political and class biased agenda. This is crucial for developing feasible alternatives at the national level to counteract neoliberal restructuring in Mexico.

Gerald Epstein has advocated a real targeting framework as an alternative policy to the predominant monetary policy of inflation targeting. The purpose of real targeting is that the central bank includes variables such as employment as key elements of monetary policy. In this approach, the central bank can choose a real target that accommodates to the historical and economic circumstances of Mexico, as opposed to a

general inflation target and sets of monetary policy instruments to achieve that target.[10] Real targeting can include poverty levels, employment growth, investment, or real economic growth as goals of economic policy. Within this framework, the central bank can be forced to identify this target and then reach it. While this framework does not ignore inflation entirely, it compels the central bank to "achieve their employment target, subject to an inflation constraint," and such an inflation constraint must depend on the particular circumstances of Mexico instead of the interests of investors.[11] Real targeting also encourages the institutionalisation of citizens and labour groups inputs into the central bank in order to democratise economic policy.[12]

Also, the problematisation of competitiveness and its implementation at different political scales can show the ways in which capital has a differentiated territorial impact within Mexico and has further weakened the capacity of citizens to bargain with local, state and national governments.[13] Emilio Pradilla Cobos has noted that the lack of democratic territorial planning and construction of scales has obstructed any attempt to reverse uneven development and inequalities within Mexico. This has not only been the case of the advocates of market discipline within the Mexican state, but the Mexican left has also tended to reproduce pragmatic and undemocratic forms of territorial organisation

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[10] Gerald Epstein, "Central Banks, Inflation Targeting and Employment Creation," *ILO Economic and Labour Market Papers,* 2, 2007, p. 12.
[11] Gerald Epstein, "Alternatives to Inflation Targeting Monetary Policy For Stable and Egalitarian Growth: A Brief Research Summary," *Paper presented at WIDER Jubilee Conference WIDER Thinking Ahead: The Future of Development Economics*, Helsinki, 17-18 June 2005, p. 16.
[12] Ibid., p. 9.
[13] Emilio Pradilla Cobos, "Lo Conocido, Lo Ignorado y Lo que Necesitamos Investigar: Distrito Federal, Zona Metropolitana, Ciudad-Regiôn del Centro," *Andamios*, 1, 2004, p. 171.

that subject workers and nature to market discipline at the local level.[14] For this reason, it is necessary to create alternative institutions that question issues of competitiveness at different political scales and increase social participation in the economic planning of the Mexican territory.[15]

The focus of this study on the articulation between international accumulation, finance and the territoriality of the Mexican state is also directed at questioning the abstract separation between the 'economic' and the 'political.' Macro-economic stability, 'the economic,' is carried out through autonomous state institution and is experienced locally through low wages, job insecurity, and lessened social spending. Democratic participation, the 'political' has become confined to voting for pre-established political parties. This study, in turn, can help us to understand the current loss of substance of Mexican political parties, which only legitimize existing policies that put downward pressure on wages.

This does not mean that fair elections and plurality in the branches of government should be dismissed as only marginal to a democratic project. It does suggest, however, the limitations of considering electoral politics, political parties, and check-and-balances between government branches as democratic processes in isolation from democratic economic decision-making. This compels a rethink of the meaning of democracy and citizenship beyond adequate rules and procedures in governmental institutions. Monetary and financial phenomena are political, social, and territorial processes that link national

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[14] Emilio Pradilla Cobos, "Neoliberalismo, Globalización, Regiones y Ciudades en Crisis," *Memoria*, 169, 2003. http://memoria.com.mx/?q=node/96 Retrieved 11 August 2007.
[15] Felipe de Alba, "Fragmentación Institucional en México: La Saturación del Espacio Político y la Acción Intergubernamental en una Metrópolis en Conflicto," *Revista Provincia*, 16, 2006, p. 138.

economic policy-making with the internalisation of global financial discipline; these forces overwhelm even fair elections and public participation in Mexico.

Neoliberalism, the Mexican State, and the Internationalisation of Capital

This dissertation's analysis of the relationship between the internationalisation of capital and the territoriality of the Mexican state, its expression in political scales in Mexico, and the role of derivatives in the Mexican economy raise further questions regarding the nature of class power, and the ways in which finance and the rights of investors it promotes, coexist with 'the transition to democracy' in Mexico. Answers to these questions require a further examination of the role of the American state in Mexico's economic restructuring. Also, a more thorough study of Mexico's political economy would have to account for the ways in which labour and the environment have been affected by the Mexican state's neoliberal policies and by the discipline of financial derivatives in specific sectors and how labour and communities have responded to this discipline.

Still, this dissertation provides a starting point to study the relationships between the reproduction of capital, the increasing sophistication of finance, and changing territoriality of the Mexican state. By emphasising the spatial dimension of capitalism and the Mexican state, this dissertation offers a framework that does not regard global capitalism as an ineluctable force, but rather as a process that depends on nation-states and localities for its reproduction. A historical focus of the territoriality of capital and the Mexican state is also a 'territorialisation of history.' This allows a different point of departure in understanding Mexico's peripheral position in global capitalism and in

particular, the subordinate relations to the United States. The internationalisation of capital in Mexico has often been regarded as the expansion of capitalism emanating from core economies that occupies 'less developed societies.' This dissertation, in contrast, recognises the crucial role that peripheral states, such as the Mexican state, have had as co-participants in the constitution of global capitalism. This enables an account which does not reduce the historical and territorial specificity of Mexico to merely resistance or passivity.[16]

Indeed, the Mexican peso continues to be issued outside the nation-state, not only by the central bank but also by other private economic actors. In this way, the Mexican peso, including financial derivatives linked to this currency, can be traded globally. This, however, does not necessarily mean that the Mexican state's power has declined or that global financial pressures have downsized the Mexican state through neoliberal policies. Such presuppositions have often led to the search of spaces outside the nation-state – global civil society and 'local entrepreneurialism' – to formulate alternatives to international capitalism. This dissertation has illustrated how the implementation of neo-liberalism in Mexico has required the intervention of the state to reproduce finance, expand market discipline, foster the internationalisation of Mexican capital, contain class struggle, and limit substantial democracy.

As such, the reclaiming of the Mexican nation-state as a territorial site of struggle needs to be included in strategies to confront the expansion of financial discipline in Mexico. It is in this context where the politisation of economic decision-making and the

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[16] Fernando Coronil, *The Magical State: Nature, Money and Modernity in Venezuela*, Chicago: University of Chicago Press, 1997, p. 8.

democratisation of the state apparatus become imperatives for a democratic project alternative to neoliberalism. This includes the replacement of inflation and exchange rate targets with issues of employment, job security, workplace democracy, and the rights of marginal communities to decide over their means of living in Mexico.

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