trade" (p. 5), since high and variable inflation would make the adjustment to a new trade regime much more costly. If trade reform had been forced on Mexico by international lending organizations as a condition for new loans, one would have expected the resulting reform to be weak and abandoned as soon as the monies were granted. Mexico's reform, however, began under extremely unstable macroeconomic conditions and proved long-lasting.

Since neither of the above hypotheses adequately fits the facts, Thacker turns to a model of domestic political coalition formation to explain Mexico's shift towards free trade. Essentially, he points out that in authoritarian polities like Mexico, where neither checks-and-balances nor the electorate effectively constrain the government, private business influences government policy by withdrawing its investment and human capital or forming coalitions with other political actors. If the power of protectionist private actors drops, perhaps because they have less capital to invest or because threats to liquidate their investments are less credible, then government policy will shift accordingly.

The book is a treasure-trove of stories about Mexico's politics during the 1980s and early 1990s. Unfortunately, one reaches the end still uncertain about *why* Mexico opened its economy so radically. Thacker's story is that Mexico's industrial structure had become more concentrated in the hands of large firms, and increasingly located in the north of the country. Those firms were more open to foreign trade. Similarly, the owners of Mexico's new privatized firms perceived greater opportunities in exporting than at home, where economic growth had slowed. Budget cuts, which decreased subsidies, further encouraged this switch in the orientation of the business sector. The ruling Partido Revolucionario Institucional (PRI), facing rising opposition to its traditional electoral fraud, found it in its interest to align with this emerging free-trade coalition. The government's commitment to liberalization was then cemented with the signing of NAFTA in 1994.

Unfortunately, Thacker's account fails to distinguish *which* of the above changes was the most important. Would liberalization have happened without privatization? Was the ruling party's loss of popular support a necessary precondition? Both privatization and the government's growing unpopularity may have been the result of exogenous economic changes. How important was the growing concentration of Mexican industry? If concentration was key, why were larger companies more in favor of free trade? Mexico's largest manufacturers, after all, had their roots in trade protection.

Thacker's book offers several intriguing hypotheses about Mexico's shift to free trade. It does not, however, adequately explain why Mexico's policies altered, or how political coalitions are constructed in Mexico.

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The Chastening: Inside the Crisis that Rocked the Global Financial System and Humbled the IMF. By Paul Blustein. New York: Public Affairs Books, 2001. Pp. 448. $30.00. ISBN 1–891620–81–9. *JEL 2002–1398*

Many countries embraced the call from what the author dubs the "High Command" (the IMF and the U.S. Treasury) for liberalization of capital movement, resulting in massive capital inflows that helped boost their economies. But when investors' expectations changed, a financial crisis emerged. Once dynamo economies of East and Southeast Asia tumbled like dominoes, followed by Russia, then Brazil. A global financial crisis of the late 1990s was in the making.

Having transformed from an institution guarding the fixed-rate system to one functioning as a lender of last resort, the IMF was heavily involved in the rescue process. Working hand in glove with the Fund was "The Committee to Save the World," i.e., Robert Rubin, Lawrence Summers, and Alan Greenspan.

The book records how the whole process evolved. Economists familiar with the analysis of financial crisis will find this manuscript highly revealing, showing how competing concepts work in the real world when there is asymmetry in power influence.

Underestimating Thailand's economic shock, the Fund misdiagnosed the source of the problem. Even with rising current account deficits, Thailand's inflation was low, and the budget was in surplus. The real problem was with financial firms, many of which issued promissory notes, borrowed short-term from banks and foreign investors, and lent heavily in properties. The resulting bubble burst in the summer of 1997. Only after Japan and China refused the request for bilateral loans did the Thai government reluctantly accept the IMF involvement.

Convinced that it was a classical first generation crisis model, the bailout package demanded an austerity program: tight money and a tight budget. This program worsened the situation. The timing of the U.S. Treasury's demand for full disclosures of swap contracts damaged confidence further.

The next domino to fall was Indonesia. Its macroeconomic indicators were better than Thailand's, but its financial sector was weaker. When contagion struck hard, the government gave in. Again, the IMF demanded an austerity program. Ignoring the absence of deposit insurance, it also forced the closure of 16 banks, causing a massive bank run. The IMF subsequently demanded sweeping reforms of the institutional structure, something outside of its expertise and mandate. A Fund staffer confessed that the structural reforms did not address the real problems: banking system weaknesses and the corporate debt burden. The sweeping change was not needed for the return of capital, nor was it required to restore market confidence.

Most would have thought that the mishandling of the two countries' economies provided a good lesson for the IMF in dealing with the subsequent crisis in Korea. Wrong. Under pressure from Secretary Rubin, the Koreans were also forced to adopt an austerity program despite the Finance Minister's warning that higher interest rates would lead to widespread bankruptcies and wouldn't help lure capital from overseas because of the limited opportunities to invest. The IMF's first program in Korea failed. Capital outflows and panics were eventually controlled only because of the bail-in program coordinated by William McDonough, the New York Federal Reserve Bank's president, who basically gave investors two choices: roll over Korea's debts or get nothing. The global repercussions of a default by Korea, an OECD member, would have been immense.

Having observed the malfunctioning of its early-warning system in Asia, IMF's Managing Director Camdessus rushed to warn the Russians to slash budget deficits and get rid of pernicious practices. This time the Fund was right. Unlike Asia, Russia's Achilles' heel was its huge public deficits financed by the state short term debt GKO. The high returns lured investors, but when the ruble weakened, the yield was forced to increase to as high as 50 percent, too much for the system to hold. Even given the alternative of exchanging it with Eurobonds, investors preferred to hang onto GKO. In their mind, Russia is "too nuclear too fail." A strong moral hazard was at work. But with damaged credibility, the IMF refrained from bailing Russia out. Investors' belief was eventually shattered by Russia's decision to default. Rules of the game and market psychology changed after that, and fears of a widespread contagion mounted.

The collapse of LTCM, which forced the Federal Reserve to bail-in, and the spread of contagion reaching as far as Brazil, prompted the U.S. administration to shift the "balance of risks," favoring easier monetary policy. But needing to calm the market for the upcoming euro launching, the Europeans opposed the idea. Echoed throughout the book, the Americans and Europeans (specifically Germans) also disagreed on bail-out packages. The Americans favored forcing countries to do structural reform in exchange for IMF bailouts, the Germans believed moral hazard would rescue wealthy Wall Street investors. The British and Canadians joined the Germans. The Japanese, feeling that sweeping structural reform involved too much conditionality, wanted to establish the Asian Monetary Fund. The plan was dashed completely by the Americans.

While ill-equipped to deal with the third generation crisis, the IMF learned its lessons. Like Korea and LTCM, Brazil was finally saved by a bail-in program. From all episodes, no successful program was achieved without bail-in.

The Fund's strict hierarchy, its damaged credibility, and heavy inputs from the Treasury and G-7, may limit the effectiveness of future policies. The IMF needs to be reformed. The author recommends more moderate reforms. This, with subsequent discussions on restructuring the international financial system and the new factors in financial crises, is the theme of the last chapter. It is narrow, too standard, and anti-climatic. Except for this chapter, the book is fascinating and well worth reading.

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