

Aaron Tornell, Frank Westermann, and Lorenza Martínez
"Liberalization, Growth, and Financial Crises: Lessons from Mexico and the Developing World"

***Brookings Papers on Economic Activity* 2:2003, pp. 1-88**

Although the case for trade liberalization is now well established, the case for financial liberalization is not, because the latter is associated with lending booms and crises. Some critics invoke as evidence the recent weak growth of Mexico, a prominent liberalizer. We argue that liberalization is beneficial despite the occurrence of crises. First, we show that financial liberalization has typically followed trade liberalization, and that both have led to faster growth, despite more frequent booms and busts. Second, we present a model that shows why, in countries with severe credit market imperfections, liberalization leads to faster growth and, as a by-product, to financial fragility. Third, comparing Mexico with this international norm, we show that liberalization and NAFTA have induced faster growth and investment but have not been enough: lack of structural reform and a protracted credit crunch generated bottlenecks that blocked further growth and led to a slowdown in exports.