WHITHER MEXICO?

A COLLOQUIUM PRESENTED BY

THE GEORGE WASHINGTON UNIVERSITY’S
CENTER FOR LATIN AMERICAN ISSUES

AND

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UNITED STATES ARMY WAR COLLEGE

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A SYNOPSIS
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A Synopsis

By CLAI Staff

BACKGROUND

Mexico’s institutions are straining to cope with a succession of crises. Drug-related homicides have risen to alarming levels, both in numbers and severity. The global financial meltdown that has sent the U.S. economy into a tailspin has hit Mexico just as hard, if not harder. And the outbreak of swine flu earlier this year devastated the tourism industry, further hobbling one of that country’s major generators of employment and foreign exchange. To gain a better understanding of recent developments in Mexico and their impact on the well-being of the country and the region, the Strategic Studies Institute (SSI) of the U.S. Army War College and The Center for Latin American Issues (CLAI) of The George Washington University jointly convened a panel of experts on May 15, 2009. The panel included:

☞ Jorge Castañeda, Global Distinguished Professor of Politics and Latin American and Caribbean Studies, New York University, and former Foreign Secretary of Mexico
☞ Nora Lustig, J.B. and Maurice C. Shapiro Visiting Professor of International Affairs, The George Washington University
☞ Francisco González, Riordan Roett Associate Professor of Latin American Studies, Johns Hopkins University

The panel was moderated by CLAI Director Dr. James Ferrer, Jr.

A DYSFUNCTIONAL POLITICAL SYSTEM

Dr. Castañeda opened the discussion by painting a somber picture of Mexico’s political system, one he described as increasingly fractured and dysfunctional. It is important to understand this, he said, because it forms the backdrop for the vaunted ‘war on drugs’.

The PRI party held power uninterruptedly in Mexico for more than seven decades. In 1994, Ernesto Zedillo, the last of the PRI presidents, won with just under 50 percent of the vote. In 2000, Vicente Fox, of the PAN party, became the first opposition candidate to defeat the PRI; he was elected with only 43 percent of the vote. And in 2006, Felipe Calderón, also of the PAN, won with a mere 35 percent of the vote. This erosion of the Mexican government’s power has been occurring not just at the executive level. In recent years both houses of parliament have been in the hands of the opposition, and in 1997 the governing party also lost Mexico City, the second most important political post in the country. Finally, of the 31 state government houses, half are held by incumbents from parties different from the national government party.
To make matters worse, averred Castañeda, from one-third to one-half of Mexicans believe that Felipe Calderón actually lost the 2006 election. But, he hastened to add, Calderón’s victory was legal, as determined by the Federal Electoral tribunal, the only body competent to make that judgment, and one that is elected by all the parties, including the PRD (which had challenged the election results).

The upcoming July 2009 elections for the lower house (elections for the senate are not scheduled again until 2012) will probably see the government’s position erode further, surmised Castañeda, although he believes the PAN will probably retain a plurality.

Mexico’s current political system is rife with inertia, continued Castañeda. Unfortunately, he said, Mexican opinion polls are poor vehicles for gauging a Mexican president’s ability to govern. Mexicans tend to like their sitting presidents, and to dislike its ex-presidents. But a sitting president’s popularity in the polls does not correlate highly with his ability to get things done.

This, said Castañeda, is the context that provides the political backdrop for Mexico’s ‘war on drugs’.

**A War of Choice**

President Calderón declared his war on drugs on December 11, 2006. He did so not because of a threat to the country’s security, argued Castañeda, but to buttress his administration’s legitimacy in the eyes of Mexican society. The ‘live and let live’ approach toward drug trafficking had worked well enough for 50 years, and none of the arguments adduced to justify Mexico’s war on drugs has much validity, insisted Castañeda.

Among the arguments adduced by the Calderón administration, continued Castañeda, are that Mexico was losing control of its territory; that drug-related violence was up dramatically; that a qualitative change was taking place, with the drug cartels assuming ever greater control over the political space; and that drug abuse among Mexicans was becoming endemic. None of these arguments holds much water, averred Mexicans. Mexico’s war on drugs is therefore a war of choice, he concluded. Mexicans will not utter this view in public, he confided, but it is widely held in private.

Calderón’s real reasons for declaring war on drugs, declared Castañeda, was his desire to bring the Mexican armed forces into his coalition in a direct way, and thereby strengthen his weak political base. He must have believed that going after the ‘narcos’ would be an in-and-out affair, continued Castañeda, but this exit strategy was flawed. And now the problems that the ‘war of choice’ had been intended to resolve appear worse than before.

In support of his arguments, Castañeda declared that ‘anyone who was around Mexico in the early 1980’s” could have ticked off the names of state governors who “absolutely everybody knew” were involved with drug traffickers. Links between state governors and drug kingpins have long existed in states such as Sinaloa, Chihuahua, Guerrero, Durango, and generally in Mexico’s border states, he said. Moreover, elements of the
Ministry of Defense had long been linked to cartels, as raids on some production facilities in 1984 had revealed.

If political officials have indeed been co-opted by the drug cartels, one would expect at least some arrests of such officials, said Castañeda. Yet not a single political figure has been indicted in the two-and-a-half years that the current administration has been in office – although some people in the army and in the police have been. This does not mean that politicians are not implicated. It means that the government is loath to go after them.

Castañeda took issue as well with the rationale that the drug on war had been launched "to protect our children." This position is not supported by a single poll or survey during this period, he said. The only data available suggest that the number of Mexican drug addicts reportedly has grown from 300,000 some years ago to 450,000 today. But this is among a population of 110 million. Does that justify going to war?

Responding to questions from the audience, Castañeda admitted to being less pessimistic than his presentation might suggest about Mexico’s ability to tackle drug trafficking more effectively. That, however, would require a more sophisticated approach that necessarily includes the development of a capable, well trained national police force. Unfortunately, he said, in the two-and-a-half years that the National Police Academy has been in operation, not a single policeman has been graduated – intelligence officers and others, yes, but no officers to do traditional police work.

A VIEW OF THE ECONOMY

Dr. González began by noting that the ‘flight to quality’ by international capital that followed upon the collapse of Lehman Brothers investment bank, in September 2008, had hit emerging economies hard. However, Latin America – and Mexico in particular – have generally fared better than many other countries, including those in the Euro zone. For a change, the genesis of the crisis cannot be blamed on the emerging markets, he said; rather, it had sprung full-blown from the very heart of international capitalism in New York, London, and Hong Kong.

Mexico has been able to weather the crisis better than it might have in years past, thanks to its fairly conservative economic management in recent years. Economic performance has, however, been mixed over this period. In the ‘good news’ column, Dr. González ticked off several developments:

• The commodities boom that occurred from 2003 through the first half of 2008 benefited most Latin American countries. Although Mexico was not one of the great ‘winners’, more importantly, it has not been one of the big losers in the ensuing commodities bust, and does not find itself in as dire straits as several other Latin American countries, among them the Andean countries and Venezuela.

• Today, the largest economies in the world have room for fiscal expansion, including the big Latin American economies. This was not the case in early 1980s or late 1990s. As a result, Mexico has been able to deploy a significant fiscal stimulus package, one that is even larger in relative terms than Brazil’s.
Inflation, which grew alarmingly in 2006-08, has eased. Although Mexico’s inflation rate is projected to remain above the world’s average, it has subsided enough to allow for a more relaxed monetary policy, thereby giving banks more room to maneuver.

Latin currencies depreciated sharply in early 2009. Although Mexico was badly affected at first, the danger of a disorderly macro-devaluation was abated, thanks to a US$ 30 billion swap line from the U.S. Federal Reserve to Banco de Mexico, and a US$ 47 billion credit line from the IMF’s new ‘flexible credit line’ program – the first such line extended to any country. Mexico, which had regularly endured balance of payments crises every six years, has not had one since 1995.

On the negative side of the ledger, Dr. González included:

- A dramatic fall in exports to the United States since the onset of the 2008 crisis, and in services such as tourism, which also are strongly connected to the United States. (The United States takes some 80 percent of Mexico’s total exports, and is the source for 75 percent of Mexico’s imports.)
- A contraction in remittances. Although remittances are not the largest source of foreign exchange for Mexico, they are the most important element in sustaining consumption among the country’s poor and very poor households.
- Mexico derives significant revenue from oil exports, and taxes from oil production. The commodity bust therefore threatens growth. Nevertheless, viewed in the broader Latin American context, Mexico it is not among the most seriously affected in this regard.

Dr. González expects 2009 and 2010 will be tough years for the Mexican economy, dependent as it is on the U.S. economic recovery. Most affected will be the five to six million poor Mexican households that depend on remittances that, before the recession, averaged US$ 250 to US$ 300 per month, but which have since contracted sharply. But Latin American countries that depend on commodity exports more heavily than does Mexico will likely fare worse.

**MEXICO’S OIL CHALLENGE**

Although Mexico’s oil sector is not as central to the economy as it was in 1980s, Mexico remains a net oil exporter and the sector still derives from 15 percent to 20 percent of its annual export earnings from that source. Oil is also the source for about a third of federal revenues, and the government would be hard pressed to compensate for any loss of that revenue.

Mexico supplies approximately 2.3 million barrels of oil to the United States per day. But Mexican oil production has been falling some 13 percent per year since 2005. The main source of this problem is the steep decline in proven reserves since 2000 because of a paucity of substantial new finds. At current rates of production and exploration, González estimates that Mexico will cease to be a net oil exporter in about 10 years. Big fields likely do exist offshore, in deep waters of the Gulf of Mexico, but a lack of financing and of technological and organizational capacity impede the national oil company, PEMEX, from exploring and producing. Mexico still does not allow foreign firms to participate in its oil sector, except through fixed-fee, multi-service contracts;
such contracts, however, are of limited interest to foreign oil companies, which prefer production-sharing arrangements.

In the electricity sector, Mexico will rely largely on natural gas to meet growing demand which, at 6.8 percent per year, will grow more rapidly than GDP. In 2005, 20 percent of gas consumption was met by imports from the US, which supplies Mexico’s northwest, a region not linked to the domestic pipeline infrastructure.

As to other forms of energy, nuclear plants supply only a miniscule amount, while hydroelectric output compares favorably with the United States in relative terms. In Latin America, only Brazil and Mexico at present have renewable energy projects of any significance – in the case of Mexico, some wind farms in the north of the country.

**Poverty, Inequality and Growth in Post-reform Mexico**

Dr. Lustig presented data showing that Mexico, which had done quite poorly in the 1980s, improved in the 1990s, albeit not dramatically.

Following the 1982 crisis, Mexico shifted its development strategy from an inward-looking to outward-oriented one. It sharply reduced barriers to international trade and foreign investment, and the economic model shifted from a state-led to a market-based one.

However, twentyfive years later, results are relatively modest. The economy has become more stable, with the external debt at manageable levels, inflation under control, and the country better positioned to withstand external shocks. But economic growth has been lackluster, with per capita GDP growing on average only 0.6 percent per year from 1983 to 2007. Total factor productivity has not grown beyond the sectors integrated with the global economy; in those sectors it rose, on average, a meager 0.7 percent between 1996 and 2003.

Moreover, despite NAFTA, there are no signs of convergence with the US economy, although Mexico’s business cycle has become highly correlated with that of the United States. Poverty in 2006 was not much lower than in 1984, although it has trended downward in recent years. Nevertheless, inequality, as measured by the Gini index, has improved. Indeed, Mexico is one of the few developing countries to see a consistent decline in inequality since the mid-1990s. What modest growth Mexico has experienced has therefore, on the whole, favored the poorer socioeconomic strata. However, regional disparities have become more pronounced since the onset of the global present economic crisis.

Factors that have contributed to reducing income inequality in post-NAFTA Mexico include rises in labor income per worker; remittances; and government transfers (excluding pensions). The rise in labor incomes accounts for about 70 percent of the total reduction in inequality, and is a consequence of the operation of market forces, rather than of government intervention.
Available evidence, continued Lustig, suggests that job creation in post-NAFTA Mexico has been stronger at the bottom of the socioeconomic scale, in low-productivity, low-wage jobs; this ‘low-wage’ job creation has resulted in ‘pro-poor’, grassroots growth. Dr. Lustig hastened to add that available data are insufficient to say whether or not this improvement has come about because of NAFTA. This jobs improvement has been an important accomplishment. However, except for the benefits accruing from greater access to consumer credit, including mortgages, the middle class, the lower-middle class and the urban moderately poor have seen little economic progress in their lives.

Current conditions do not bode well for Mexico, continued Lustig. Thanks to the U.S. “great” recession and the impact of the swine flu pandemic, she said, Mexico may see its GDP decline by 5.0 percent or more in 2009. Unemployment has already risen by more than one percentage point, and is above 5.0 percent (Mexico’s official unemployment rate is historically lower than that in the United States.). Meanwhile, remittances have been falling (Mexico was the first country to experience the phenomenon upon the onset of the global recession); together with rising food prices, higher unemployment, and lower incomes, extreme poverty is likely to rise. Nevertheless, the sectors more likely to feel the “squeeze” are the middle class, the lower-middle class, and the urban poor. Government transfers should help cushion the impact on the extremely poor, but programs to help cope with job loss, such as unemployment insurance, are very limited in Mexico. Social discontent is therefore likely to rise.

Given this scenario, Dr. Lustig recommended that the Mexican government take the following measures:

- Use counter-cyclical fiscal and monetary policies as much as possible.
- Since it cannot improvise a safety net for the workers that will be shed, it should use unconventional measures (e.g., access to credit, waiving social security contributions, etc.) to help contain the unemployment rise in the formal sector.
- Expand the safety net for workers and households in the informal sector through targeted programs such as Oportunidades, Programa de Empleo Temporal, and others.

The U.S. government can help Mexico, said Lustig, by:

- Continuing to provide support for greater access to financial resources through bilateral channels (e.g., US Fed swap arrangements) and multilateral channels (the International Monetary Fund and the multilateral development banks).
- Relaxing the crack-down on undocumented immigration.
- Complying with NAFTA commitments and avoiding contingent protectionism.

For the longer run, Dr. Lustig concluded, both governments need to determine how best to accelerate Mexico’s economic convergence with the United States.

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The views presented in this document do not necessarily represent those of the Strategic Studies Institute, of The Center for Latin American Issues, or of their respective parent organizations.