

## Introduction

### Mexico's Political Economy

The idea the Mexican people have of the United States is contradictory, emotional, and impervious to criticism; it is a mythical image. . . . In general, Americans have not looked for Mexico in Mexico; they have looked for their obsessions, enthusiasms, phobias, hopes, interests—and these are what they have found.

—OCTAVIO PAZ, 1979

I see where we are starting to pay some attention to our neighbors to the south. We could never understand why Mexico wasn't just crazy about us; for we have always had their good will, and oil and minerals, at heart.

—WILL ROGERS, 1928

This book examines the repercussions of the dependent-dominant relationship between Mexico and the United States. “Repercussions” refer to the shaping of policy initiatives by either country, the initial responses by the other country, how outcomes have been determined and with what consequences. On a larger canvas the dependency-dominance outlook of the two countries have shaped the attitudes and behavior not only of governments, but also of the populations of each country toward the other. The character of the two governments as they interact with each other has been permeated by this sense of dependence on one side and dominance on the other. Individual thinking that Mexico is a dependent (and hence inferior) nation may be built into the consciousness of many Americans (*norteamericanos*). Many Mexicans have reached a related conclusion, mostly with little forethought, not that Americans are superior, but that their country is dominant and consequently it often behaves arrogantly. One way of expressing this Mexican attitude is that Americans think of Mexico as its backyard, not as a sovereign and equal neighbor. This expression received much attention in

both countries when, shortly after he used it in 2003, Adolfo Aguilar Zinser was dismissed as Mexico's ambassador to the United Nations.<sup>1</sup>

This attitude of dependency-dominance has many origins. One of these is the self-evident asymmetry in economic and political power of the two countries. Many Mexicans, when they use the word *asymmetry*, have in mind such things as Mexico's dependency on the United States as an escape valve for emigration and the heavy reliance on the U.S. market for exports. However, asymmetry is a common phenomenon in U.S. relations with other countries, and global use of the dependency-dominance characterization would not be appropriate in all those instances. Mexico is a neighbor of the United States, but that reality makes *asymmetry* insufficient by itself to characterize the relationship.

Mexico, over the past 150 or so years, has suffered many humiliations from the United States. The most severe was the loss of half its territory in the Treaty of Guadalupe-Hidalgo in 1848, after Mexico's defeat in the Mexican-American War. Use of the military to demonstrate dominance or to grab territory was not uncommon in the nineteenth and early twentieth centuries; this was one way U.S. power manifested itself at those times. One can cite comparable dominance and territorial aggrandizement between other pairs of neighbors, one weak and the other strong, such as Germany and Poland and Japan and Korea. For most Americans this land grab is a footnote in the U.S. experience; for Mexico, though, it is probably the dominant event of its modern history. There have been other humiliations. One such example was the interference of the U.S. ambassador in the overthrow of Francisco Madero (the leading figure in the ousting of Porfirio Diaz) in 1913, after the Mexican revolution in 1910; this became known in Mexico as the *pacto de la embajada*, or the deal struck in the U.S. embassy. And there were the military incursions into Mexico in 1914 when U.S. President Woodrow Wilson gave orders for a naval occupation of Veracruz.<sup>2</sup> Indeed, the form that Mexican nationalism has taken stems from these humiliating events.<sup>3</sup> The Mexican mantra of "no interference in the internal affairs of other countries" stems from this bilateral history.

Octavio Paz, probably Mexico's outstanding philosophic analyst, argued during his lifetime that the differences that exist between Mexico and the United States stem not from the well-known "opposition between development and underdevelopment, wealth and poverty, power and weakness, domination and dependence," but rather from the reality that the two coun-

tries are “distinct versions of Western civilization.”<sup>4</sup> Paz is well known in Mexico and among Americans who write about Mexico for the following ideas, among others: that people of each country have a mythical image of the other; that the history of the relationship is one of mutual stubborn deceit, usually involuntary; and that the United States is a society oriented to the future while Mexico’s orientation is just the opposite, to what he calls a “plurality of pasts, all present and at war within every Mexican’s soul.”<sup>5</sup>

Paz was the outstanding interpreter of his own country’s patterns of thought, and he was also informed about the United States, but some of what he described may apply to relations between other countries. The United States revels in its repeated victories—over Mexico, Spain, in two World Wars, and in the Cold War. Mexico is not the only country that has had repeated military defeats with accompanying national remembrances. Hungary and Poland may be other examples. The people of these countries take pride in other accomplishments and in their survival—not their expansion. But U.S. history is more ambiguous than these “victories” just described: for example, the United States lost the War of 1812, but that was long ago, and it has failed to come out of more recent wars with unquestioned victories, such as in Korea and Vietnam. Who knows how history will assess the war in Iraq? At the end, in an article he wrote during the Cold War, Paz asserted that the mortal danger the United States then faced came from within: “from that mixture of arrogance and opportunism, blindness and short-term Machiavellianism, volubility and stubbornness which has characterized its foreign policies during recent years.”<sup>6</sup> Many of these observations have had validity in recent U.S. foreign policy.

History has clearly played a large role in generating Mexico’s sentiments of dependency, but so does Mexico’s inability to deal effectively with economic and political problems during the past thirty-plus years. These troubles have included, on the political side, the government’s inept and violent handling of the 1968 student uprising and the long duration of faux democracy under the Partido Revolucionario Institucional (the PRI, the Institutional Revolutionary Party); and on the economic side, the inability of Mexico’s political process to confront and resolve basic structural issues relating to tax collections, fiscal policy, the prevalence of monopolies, and corruption. This inability is covered later in the chapter.

In 2004 two Mexican institutions—the Centro de Investigación y Docencia Económicas (CIDE), a research and higher education institution, and the

Consejo Mexicano de Asuntos Internacionales (COMEXI), an independent foreign affairs think tank—teamed up with the Chicago Council on Foreign Relations, which had surveyed U.S. public opinion on foreign affairs for decades, to do a parallel study in both countries. Two important findings of that study are highlighted. The first is that 68 percent of Mexicans had warm feelings for the United States, and no other country ranked higher. Mexico ranked third behind Great Britain and Germany in terms of warm feelings of Americans. The second key finding is perhaps more revealing: 63 percent of Mexicans polled supported permitting Americans to work alongside Mexicans in guarding Mexico's airports, seaports, and border with the United States. This willingness contradicted just about everything Mexican leaders, politicians, and intellectuals had been saying.<sup>7</sup>

CIDE and COMEXI directed a second opinion survey in 2006 that was more expansive than the earlier survey, and added an interesting wrinkle comparing the views of Mexican leaders and the Mexican public on a number of issues. The warmth of feeling of Mexicans toward the United States rose to 74 percent in the 2006 survey, but the warmth toward Canada was higher, at 75 percent. Warm feelings of Americans toward Mexico were 47 percent, lower than toward five other countries (Great Britain, Australia, Japan, Germany, and Israel, respectively). There were significant differences between the views of leaders and the general public on some issues. One such difference was on accepting the presence of U.S. agents on Mexican soil cooperating with Mexican authorities: 51 percent of the Mexican public supported the idea, while only 29 percent of the leaders did. There were 1,499 general public interviews, and 259 interviews with leaders from government, politics, business, media, and nongovernmental organizations.<sup>8</sup>

Opinion surveys, as is well known, measure sentiment at a single point in time; they can be biased by the way questions are framed. Yet it is noteworthy that there was little change in the views cited on the two aspects of Mexico-U.S. relations in the successive surveys. Even at the time these extensive polls suggested that the majority of Mexicans had a *positive* attitude toward the United States, however, BBC polls taken during the same period indicated that the majority of Mexicans had a *negative* attitude toward the United States.<sup>9</sup> One explanation for this simultaneous contradictory evidence may be in the difference between overall sentiments (the CIDE-COMEXI polls) and attitudes on specific issues. The negative Mexican view in the BBC polls is centered on U.S. actions in the Middle East, especially the Iraq war.

One cliché describing the bilateral situation is that it is a love-hate relationship. There is a scintilla of accuracy in this characterization, but not much more: there is little hate on either side, and “love” is the wrong word. Respect for the United States exists to some extent on the Mexican side, but perhaps opportunism is a better way to put it—that is what drives migrants from Mexico. The title of Alan Riding’s 1984 book, *Distant Neighbors*, captured a real phenomenon. But some 10 percent of the Mexico-born population now lives in the United States, and the kinship relations they have with families in Mexico reduces “distance” appreciably. Vicente Fox, when he was president of Mexico, often claimed these U.S. residents as part of his constituency. He was right in that many had dual citizenship, but they had no deep affinity with Fox or his political party; the affinity they had was largely with their relatives back in the home country.

Characterizations of attachment, fondness, admiration, and distance between the two countries all have validity, but only in a limited context. The Mexican word *gringo* or *gringa* started out as a way to express contempt for an American, but today the word is used just as often as an expression of affection. “Chicano,” when used in the United States, is used to describe a group of Mexican-origin people with no real connotation of friendship or distaste. The Mexican media often react sharply to offensive statements by members of the U.S. Congress on the assumption that this must reflect government policy, although by now most educated Mexicans know this is not so. The U.S. system with its separation of powers permits congressional members of the party of the president to take whatever position they think their constituents prefer, regardless of the president’s views. One recent example of this was the opposition of the Republican congressman James Sensenbrenner of Wisconsin in 2005, when he was chair of the House Judiciary Committee, to President George W. Bush’s proposal on immigration legislation. Such opposition is rare in a parliamentary system, especially from a legislative committee chair. During the years that the PRI was in power and the Mexican legislature rubber-stamped whatever the president wanted, this was akin to a parliamentary system, and offensive anti-American statements by legislators could not be dismissed summarily as unrepresentative of the view of the executive branch. Now that the Mexican congress is a de facto independent branch of government, the situation of individual legislators is much as it is in the United States.

Both governments regularly pronounce that relations between Mexico

and the United States are good. In the limited sense that there is practically no official name-calling and the two countries generally agree on issues of foreign policy, this is true. They did not agree, however, when Mexico, from its temporary position on the Security Council of the United Nations, indicated in February 2003 that it would not support a U.S. invasion of Iraq. Opposition to the U.S. invasion was widespread in the Security Council, and the United States withdrew the resolution. Mexican opposition to such a major U.S. proposal was unusual. Indeed, many Mexicans had argued against taking a nonpermanent seat on the Security Council for fear that their government would have to take positions antagonistic to the United States. This concern was a reflection of the dependency syndrome.

## Specific Issue Areas

The central hypotheses of this book are twofold: (1) the belief that Mexico approaches the United States with diffidence because of its sense of dependence, and (2) that the U.S. reaction to Mexican proposals, or when the United States submits its own initiatives that affect Mexico, is as the dominant player. These hypotheses are tested in six policy areas: trade, foreign direct investment and finance, narcotics, energy, migration, and the border. Each area is important to the bilateral relationship. The argument is not that behavior on either side is static, but rather that as one goes back in time, the unfolding of bilateral policy was largely defensive on the Mexican side and aggressive on the U.S. side. The approaches changed in each area over time—Mexican positions gradually became more insistent and U.S. behavior less domineering—but the earlier habits have not completely disappeared. With respect to dependent-dominant interaction, the more it disappears, the more productive the bilateral relationship will become.

The main time period covered is from 1954, when the “Mexican growth miracle” was at its zenith, to the present. However, much attention is given to the period beginning with the 1982 debt crisis, because it was then that the Mexican government had an epiphany: it realized that whatever benefits earlier economic policies had, and these were in fact substantial, they were no longer suitable. The main economic changes after 1982 were to look outward rather than inward, to give emphasis to export promotion rather than export pessimism, to rely less on central government dominance and management of the development process, and to stress the role of the private sector and

the market. One of the key manifestations of this change was the decision to adhere to the General Agreement on Tariffs and Trade (GATT) in 1986, an action that the Mexican government specifically rejected in 1980. Greater import opening and export promotion began in the few years before Mexico actually joined GATT, but the symbolism of joining the most important world trading body by a populous developing country was substantial both inside Mexico and throughout the rest of the world. Being part of the negotiating group that led to the formation of GATT after World War II was a big deal. GATT has since been replaced by the World Trade Organization. The metamorphosis of Mexico's trade policy is laid out in more detail in chapter 2.

Two areas in which Mexico has shifted from deference to public assertiveness are migration and narcotics trafficking. In 2001, in the migration area, Jorge Castañeda, then the foreign minister in the newly constituted Vicente Fox administration, said that what Mexico wanted was "the whole enchilada."<sup>10</sup> This referred mainly to the legalization of unauthorized Mexican immigrants in the United States and a large temporary worker program. Mexico had previously been quite diffident in pushing its position on migration issues. Mexico's migration policy before a change was made in the 1980s was to consciously have no policy in order to avoid interfering with U.S. policy in this area. The Mexican government learned that noninterference in U.S. policymaking was not normally reciprocated by the United States in Mexico. Migration issues are discussed in detail in chapter 6.

The second example reflecting Mexico's shift to assertiveness concerns the country's antinarcotics policy. President Felipe Calderón berated the United States for not contributing its fair share to a cooperative effort when he met with President George W. Bush in Mérida, Yucatán, in March 2007. Bush subsequently sought legislation to provide equipment to help Mexico in its struggle against the country's drug cartels. When the legislation was being considered in the judiciary committee of the U.S. Senate, a number of conditions were attached, including the requirement that the U.S. Department of State would have to verify that the Mexican police and military were not violating the human rights of those being accused of drug trafficking. It is important to keep in mind that thousands of Mexicans were being killed each year in a struggle among drug cartels for dominance in the lucrative U.S. drug market. The Mexican minister of Gobernación (usually translated as "minister of the interior"), Juan Camelo Mouriño, said on June 2, 2008, that these conditions were unacceptable because Mexico had a sovereign right to

defend its national security and that human rights were well protected under Mexican law. In the end the legislation was worked out to the satisfaction of Mexico.<sup>11</sup> In large part this was accomplished after the use of quiet diplomacy by the Mexican ambassador in Washington, D.C.

Of these two examples of Mexico pushing its positions more aggressively than had been the norm, only the antinarcotics cooperation was successful. The second arena, on achieving the whole enchilada in the immigration field, did not succeed. The lesson from this partial record is evident: that an assertive policy stance will succeed or fail depending on the issue, the timing, the importance of the issue to the United States, and its context in the overall relationship.

## Aspects of Negotiation

The dependency-dominance relationship can be observed over time in the way proposals are made and reacted to, but it also takes the form of not making any proposal at all. For example, Mexico did not make a proposal to negotiate bilateral trade with the United States until after the debt crisis in 1982 and the demise of its import-substitution policy. One purpose of this policy was to keep the United States at a distance. There really was nothing to negotiate as long as Mexico was unwilling to make import concessions and did not covet further expansion in the U.S. market. The logic of Mexico's export pessimism credo was that there was little purpose in growing Mexico's market in the United States, because this would lead to new U.S. import restrictions on the successful products.

Similarly, Mexico did not negotiate energy policy with the United States. Mexico, based on the letter of its constitution and the emotional antipathy to private equity investment in oil resources, had no basis on which to enter into joint ventures to find the funds and develop expertise for deepwater exploration for oil. For many years Mexico chose to have no stated migration policy relative to the United States, a position rationalized under the strongly held Mexican belief of no interference in the internal affairs of other countries. This policy of having no policy changed after the United States enacted immigration legislation of 1986, however, which for the first time limited the number of Mexican immigrants. After that the positions of the two countries reversed. It was the United States that refused to discuss general immigration issues—that is, other than migration of business and professional people,

in the negotiations leading to the North American Free Trade Agreement (NAFTA). Indeed, the United States was blunt on this point: there would be no negotiation of U.S. general immigration policy if Mexico wanted negotiations on NAFTA to continue. The U.S. government at that time (1993) took the position that increased Mexican exports would lead to a decline in emigration to the United States. As was quickly learned, exactly the reverse happened.

Mexico's long history of diffidence in negotiating with the United States showed up in the concern about entering into NAFTA with the United States, even though it was the Mexican president, Carlos Salinas de Gortari, who had made the initial proposal. The fear of the Mexicans who were hesitant about NAFTA was that it was a high-risk adventure because Mexico would reluctantly have to adopt policies forcefully promoted by the United States.<sup>12</sup> Participants on the Mexican side of the NAFTA negotiation reported that U.S. negotiators were indeed tough, but that the chief negotiator, Julius (Jules) Katz, was true to his word: when he promised something, it was delivered. Indeed, the outcome of the negotiation was more balanced than a good many Mexican skeptics feared. A well-researched analysis of the negotiations by Antonio Ortiz Mena, a Mexican academic, argued that at the end of the day, Mexico achieved its main objective of improved access to the U.S. market for its goods and was able to maintain its position of making no important changes in energy policy—although one might question that keeping the status quo in energy best served Mexico's long-term interest.<sup>13</sup>

The literature on asymmetrical bargaining makes clear that the more powerful partner in a negotiation does not always prevail. John Odell, in a study written almost thirty years ago, noted that in twenty-five cases of dispute settlement involving the United States and Latin American countries, the outcome ended favorably for the United States in twelve cases, six ended in compromise, and the other seven ended favorably for the Latin American country.<sup>14</sup> William Habeeb, a consultant with expertise in international negotiation, has made the point that the weaker state generally has more at stake and will devote more energy to the issue, thereby altering the negotiating balance.<sup>15</sup> William Zartman, an expert on conflict management, in his analysis of why the weaker party gets traction in negotiations with stronger parties, makes particular reference to clever tactics, the distraction of the powerful country from many other issues, and the constraining effect on the powerful country of the entire relationship.<sup>16</sup>

Zartman's injunction to keep the entire relationship in mind is important. The United States would have preferred that Mexico loosen its restrictions on private equity investment in Mexican oil production and exploration, but it held back on this issue lest the entire negotiation collapse because of the intense opposition of the Mexican public to this change. No matter how much the United States wanted the change, no Mexican government up to this point in time has felt that it could propose the necessary constitutional amendment and survive. Mexico was able to say "no" because the entire relationship was at stake and the U.S. negotiators recognized this. Still, on issues important to the United States, its position will generally prevail. The U.S. position has prevailed on border security, on immigration, and on drug trafficking, although these positions may not be optimal, just as the Mexican position on oil may not be wise in the long run. These issues, in the U.S. scheme of things, are more important than the outcome of a single trade dispute in which the stakes tend to be relatively low.

## The Mexico-U.S. Relationship in Context

Although the Mexico-U.S. relationship is evidently one between unequals, a reality that cannot be changed in the foreseeable future, it has also been influenced during the post-NAFTA period by the low economic growth of Mexico, lower indeed than that of the more developed United States over much of this period. The effect of the dependency-dominance dyad depends not just on the established relative power positions, but also on significant changes that are taking place. If Mexico had grown at, say, 7 percent a year since NAFTA instead of by 2 to 3 percent, its influence and bargaining position with the United States would be much stronger than it is today. Seven percent annual growth sustained over several decades is not fanciful—such countries as China and India have surpassed this.

### **Mexico's Growth Problem**

The question to ask, consequently, is, Why has Mexican GDP growth been so low over this period? Given that Mexican exports have more than quadrupled from 1993, the year before NAFTA came into effect, to 2007, why didn't this raise GDP growth more? One partial answer is that imports grew almost as much, thereby limiting the increase in *net* exports; imports grew by about four times over this same period. However, Mexico's GDP growth since

the economic crisis of 1982 through 2008 has been less than 2.5 percent a year, or about 0.5 percent per capita a year. During what has been dubbed the “Mexican miracle” (the period between 1961 and 1980), annual GDP growth was more than 6.5 percent a year, or about 3.5 percent per capita.<sup>17</sup> The 1980s are known in Latin America as the “lost decade,” a decade of repetitive debt rescheduling and GDP growth of about 1 percent a year. The basic explanation for Mexico’s low GDP growth after the miracle years has been the inability to make the structural changes that are essential for economic growth. Structural in this context includes such aspects of a country’s socioeconomic underpinning as education, the justice system, labor laws and practices, the fiscal situation, the ability (or inability) to collect taxes, management of the energy sector, the extent of poverty, and the degree of income inequality among the population. These are the areas in which Mexico failed; or one can say, these are the areas in which the Mexican political system failed to promote the national interest and instead gave more attention to partisan politics and powerful special interests.

The bulk of the increased Mexican exports stimulated by NAFTA came from central Mexico, especially Mexico City and the neighboring state of Mexico, plus the six northern states that abut the United States, where most of the maquiladoras, or assembly plants, are located. The word “assembly” connotes a low level of value added; this was largely true when the maquiladora operations were created in the late 1960s to provide employment for the Mexicans who were expected to return home when the bracero program with the United States was ended in 1964. However, these facilities, where laborers add the labor-intensive aspects to partially completed products sent from the United States, have since become more sophisticated. The maquiladoras now produce auto and computer parts rather than the clothing and textile products that dominated maquiladora production in the early years.

The advantage of maquiladora production was that the tariff paid on the return of finished goods to the United States was only on the value added in Mexico. Once NAFTA came into existence, though, most U.S. import duties on goods originating in Mexico went to zero. Income and opportunity inequality among the Mexican states has long been a problem, and NAFTA widened the division. As an *Economist* special report on Mexico in the November 18–24, 2006, issue has indicated, nine states in south and southeast Mexico, which have about a quarter of the country’s population, suffer from poor education and receive less investment than the more fortunate states in

central and northern Mexico.<sup>18</sup> This regional inequality is a structural problem and the relatively low level of economic growth in the poorer states limited the extent of national GDP growth occasioned by NAFTA.

Figure 1.1 shows the trajectory of real GDP growth (and declines) in Mexico from 1954 through 2007. The year 1954 is chosen as the starting date because there was a currency devaluation, and the new exchange rate held steady for more than twenty years. The stability of the Mexican peso, combined with a cautious development policy known as “stabilizing development,” produced excellent results. The big shift to what was called “shared development,” ostensibly to reduce income inequality, took place during the administration of Luis Echeverría Alvarez from 1970 to 1976. One of the outcomes of his *sexenio*, or six-year term, was the unsustainable inflation that stemmed from large fiscal deficits that brought on currency devaluation at the end of his term. This was the first of what became a succession of mostly end-of-term *sexenio* crises that was not broken until the end of the term of Ernesto Zedillo Ponce de León, when he passed the presidency to Vicente

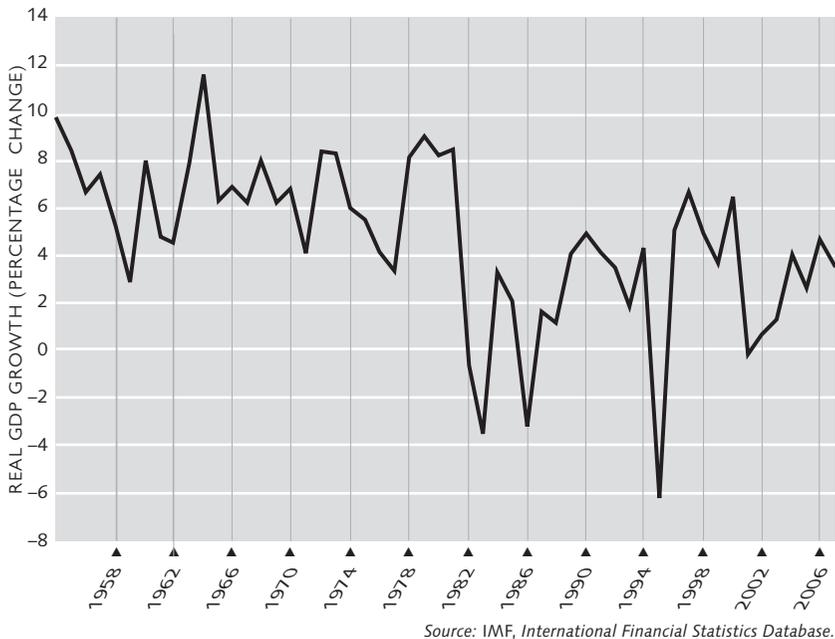


Fig. 1.1. Mexico: Real GDP growth (percentage change), 1954–2007

Fox in 2000 without a currency crisis. These successive crises had a large impact on young people growing up in that period of some twenty-five years. They had learned that any pesos they had at the end of a sexenio would be worth less when the next sexenio began because of the expected devaluation. What they fathomed, if they were even slightly perceptive, was that it would be smart to get rid of pesos as best they could before the sexenio ended.

When Felipe Calderón Hinojosa delivered his first Informe, or message to the nation, on September 2, 2007, he noted that he inherited a stable economy, presumably to provide a contrast to the history of sexenio crises, and made the following points on economic deficiencies: insufficient economic growth, inadequate job-creation, insufficient infrastructure, need to collect more taxes to invest in social services, 40 percent of the population living in poverty and fourteen million living in extreme poverty, shrinking energy reserves, unequal opportunities, inadequate access to education, and environmental degradation. The key problems Calderón cited were structural in nature. Fox had done little to correct these inadequacies, and Calderón said he would tackle them. He faced a formidable problem in that while his party, the Partido Acción Nacional (PAN, the National Action Party), had a plurality of the seats in the chamber of deputies, it did not have a majority. This required that Calderón bargain with other parties, especially the PRI, to pass legislation to deal with structural impediments to economic growth.<sup>19</sup>

A word or two on the nature of the key economic structural issues is in order. A good place to start is the fiscal situation. Fiscal policy is part of any country's general economic policy and not necessarily structural in the sense defined earlier. The issue here is not one of equilibrium in revenue and expenditures, which has been achieved in Mexico in recent years, but rather how the revenue is raised, what programs are neglected, and the impact of these processes on other issues. Mexico, until the 2009 economic crisis, collected about 11 percent of GDP in taxes, which is low even by Latin American standards, and its expenditures are closer to 19 percent of GDP.<sup>20</sup> (For 2009, a year of economic crisis in Mexico, tax collections, according to the Bank of Mexico's central bank, was about 9 percent of the GDP.) Most of the difference, about 6 percent of GDP in normal years, is taken from the gross revenue of *Petróleos Mexicanos* (Pemex), the national oil company, to finance the general federal budget. Pemex has a monopoly on both upstream (exploration and production) and downstream (marketing, such as gasoline and diesel stations) oil operations. (Pemex also controls most natural gas exploration and

production, but two other government-owned monopolies control electricity distribution, Comisión Federal de Electricidad and Luz y Fuerza del Centro. They are not efficient companies.) Consequently, Pemex in most years operates at a bookkeeping loss because of the large government take and is unable to finance its own exploration and production.<sup>21</sup>

Thus Pemex became a cash cow for funding the federal budget, rather than being able to operate in a businesslike manner. The company, the largest in Mexico, has been unsuccessful in recent years in finding enough new oil to replace the oil that is produced—and even that is declining rapidly, as old wells become less productive. Mexico's proven reserves are now down to an estimated nine years. The best prospects for finding new oil are in the deep waters of the Gulf of Mexico, and Pemex has no experience with such drilling and lacks the money to undertake take these expensive risks. Mexico has tried to entice foreign oil companies (both private and national) to drill in the deep waters of the Gulf under service contracts but has attracted little interest. These companies do not wish to act as service providers, but rather as equity risk takers able to book the oil as they seek financing and share in the benefits of success. Pemex is unable to do this because the Mexican constitution prohibits private equity in Mexico's oil resources.

The structural issue in the energy field is thus the combination of inadequate tax collection and the misuse of Pemex revenues, which has become a creature of the needs of Mexico's treasury ministry (the Secretaría de Hacienda y Crédito Público). Consequently, neither tax collection nor the operation of Pemex is satisfactory. The Calderón administration was able, with the cooperation of the PRI, to convince the legislature to pass a new asset-based single-rate business tax in 2007 called the Impuesto Empresarial a Tasa Única (IETU). Companies will pay the greater of either the new IETU or the existing income tax at 28 percent. The single rate started at 16.5 percent in 2008, rose to 17 percent in 2009, and reaches its final level of 17.5 percent in 2010. Without getting into the details of what is included in or excluded from the asset base on which this tax is calculated, it was expected to add as much as two additional percentage points of GDP to the government tax take. However, there is much business opposition to this tax, and it is unclear whether it will survive. A thoroughgoing tax overall is what is needed.

Mexico may become an oil importer by the end of the current sexenio or the beginning of the next if some corrective action is not taken. Pemex is unlikely to find another important oil deposit in the shallow waters of the Gulf

of Mexico, as it did with Cantarell, one of the largest oil wells in the world and Mexico's largest single oil source. Mexico is already an importer of natural gas. Calderón succeeded in 2008 in getting new energy legislation enacted that focuses on making Pemex a stronger company, but it did not propose any constitutional change to allow private investment in Mexican oil operations.

Mexico has two groups of full-time workers: a first group, the formal workers, receives the benefits of the social security system, which include health care and retirement benefits, plus payments from employers if workers are discharged; and a second group, the "informal" (though legal) workers, who do not receive these benefits (although they do receive some social services from the government). The formal workers pay income taxes; the informal workers do not. The termination benefits to formal workers are typically three months of salary plus salary of twenty days per year of service. These immobility benefits, as they are called, were enacted at the urging of workers and labor unions to protect them in their dealings with their more powerful employers. However, employers have ways to avoid paying termination benefits by not hiring workers on a full-time basis, or by hiring them informally. About half of the workers in Mexico are formal and the other half informal. Many people in the informal economy are self-employed. The data on formal workers come from the social security institutions where they are registered.

The International Monetary Fund estimated that the size of the informal economy was 30 percent of GDP in 2006.<sup>22</sup> When the business tax mentioned earlier was enacted, another provision of the law was to impose a 2 percent tax on monthly cash bank deposits of more than twenty-five thousand pesos, as a way of getting people in the informal economy to pay their share. It is unclear if this will work as intended. Probably not, because there are many techniques for those targeted to avoid the tax, such as keeping monthly deposits less than twenty-five thousand pesos.

Mexico does not outdo all other countries in the number and significance of monopolies or oligopolies, but it is up there with the leaders. The key government institutions in Mexico dealing with oil, natural gas, and electricity distribution are monopolies. When Teléfonos de México (Telmex) was privatized in 1990, there was provision for a temporary six-year monopoly, but the private company was able to maintain monopoly prices for some eighteen years, although there are now stirrings of competition. Telmex has been one of the world's most expensive companies for long-distance telephone calls, as it added its local charges for transfers to and from overseas companies. Gov-

ernment officials, through the Fox administration, were complicit in allowing monopoly prices to continue. Calderón has shown greater concern over the adverse effects of monopolies. Telmex was the outstanding private example of Mexico's widespread oligopolies.

In addition to the cost of monopolies, special tax privileges for many companies are written into Mexico's budget. Tax avoidance and evasion are standard practice in Mexico, and there has been little will to crack down. The result is often higher prices in Mexico than in the United States, especially for such services such as the Internet, fixed and cellular telephones, residential and commercial electricity, cable television, and bank commissions on credit card purchases. During 2008 the price of gasoline was lower in Mexico than in the United States because of a government subsidy. This attracted U.S. drivers at the border to fill up their tanks in Mexico. The Asociación Nacional de Empresarios Independientes (ANEI), a lobbying organization of small and medium-sized businesses established to provide advice to Calderón, has argued that because the Mexican economy was opened to foreign competition after 1982, while the domestic economy remained replete with monopoly and oligopoly pricing, the competitive position of its member firms was compromised.<sup>23</sup>

### **Social Inequality**

The most important structural problem in Mexico is primary and secondary education because its inadequacy compromises everything else well into the future. The Organization for Economic Cooperation and Development (OECD) reported that in 2003 money spent on education per student was higher in Mexico than the OECD average but that student performance in reading, math, and science was below the average. The implication is that much money was being misspent. Mexico spends about 25 percent of its education funds at the tertiary college and university level, and the rest at the primary and secondary levels combined. This is a form of subsidization of the rich; the cost to the student at the National University (Universidad Nacional Autónoma de México, UNAM) and to the public state universities is negligible. The labor union for primary and secondary education, the Sindicato Nacional de Trabajadores de Educación (SNTE), is one of Mexico's largest, with almost 1.5 million members, and most powerful *sindicatos*. It has been headed for years by Elba Esther Gordillo. She also has held high positions in the PRI, and there was even speculation that she was a *presidenciable*, a pos-

sible candidate for president of Mexico. She was not chosen and then left the PRI. The union has more power over disbursement of funds budgeted for primary and secondary education than does the government; it also dominates the hiring and replacement of teachers.

The comparison of expenditures and results between Mexico and other OECD countries is not fully fair. The OECD is a club of mainly rich countries (Mexico became a member in 1994), and the comparison with countries like those in Western Europe, Japan, Canada, and the United States will inevitably be unfavorable to Mexico. The first language for many in Mexico's Indian population is not Spanish, the country's poverty rates are higher than in the other OECD countries, and large areas of the countryside are isolated from population centers. There, some schools have no teachers, only teacher aides who oversee the children and turn recorded lessons on and off. Mexico will not attain its development goals unless its educational system is improved by bringing teachers to rural areas, providing students with books and equipment such as computers needed for a modern education, and truly delivering a program that leaves many fewer young persons behind.

Although its relations with the United States are deeper than those of any other country—except perhaps Canada—this is not showing up in the number of Mexicans studying in U.S. universities. More than 80 percent of Mexico's exports are to the United States, and most of the foreign investment in Mexico comes from the United States. For the 2006–2007 academic year, however, the Institute of International Education reported that Mexico ranked seventh among foreign countries sending students to tertiary-level education in the United States, behind India, China, South Korea, Japan, Taiwan, and Canada, respectively. Some of these countries are more populous than Mexico and some less populous. The number of Mexican students at the tertiary level in the United States in 2006–2007 was 13,826, or 2.4 percent of all foreign students. Some 60 percent of the Mexicans were undergraduates, unlike the students of other countries, where the focus is on specialized postgraduate studies in areas important to national development. Many of the Mexican students arrive with poor English skills. There is also a reverse flow of American students to Mexico, about ten thousand in 2005–2006, more than to any other Latin American country.<sup>24</sup>

Many Mexican students who study abroad, especially at the postgraduate level, are financed by scholarships from governments or other institutions. An organization named Comexus was created in 1990 to administer U.S. and

Mexican scholarly programs (the U.S. Fulbright Program and Mexico's García Robles Program). One way to expand graduate student interchange is to provide more funding to Comexus on both sides. Educational exchange is an important way to improve cultural and social interchange and for Mexicans to obtain the high-level technical education that is available in U.S. universities.

Visitors to Mexico see the beggars on the streets of Mexico's large cities and in popular tourist centers. When their taxis stop, they also observe the shows of juggling, acrobatics, fire eating, and the like of poor but energetic Mexicans seeking a handout of a few pesos. The visitors understand quickly that there is poverty in Mexico. The reality, however, is that they may be observing people who came to the cities from rural areas to escape even greater poverty. Mexico's worst poverty is in the rural areas that visitors rarely see. This rural poverty is systemic and hard to eliminate.<sup>25</sup>

Mexico's imports from the United States increased by 240 percent between 1994 and 2003—that is, after NAFTA came into effect—as compared with the average annual level of imports between 1984 and 1993. Simultaneously, Mexican corn production increased after 1994.<sup>26</sup> Corn is a staple food in Mexico. Much corn is produced by subsistence farmers in rain-fed areas (without irrigation) in southern and eastern states, where soil conditions are poor and where poverty has long existed. Some of the residents own small farms; others are sharecroppers and hired help who seek work on and around these farms at planting and harvest times. What many people from these areas do if they are even modestly risk-taking is to move to cities to improve their own lot and that of their families. The exit is not a tragedy, but the result of a normal desire to find something better. Trying to keep people in the rural areas may simplify the problems of cities but at the cost of much personal stagnation. In any case it is ineffective, and thus there is heavy migration from Mexico's poorest areas to the cities and thence across the border into the United States.

The situation for the very poorest has been improved in recent years by Mexico's groundbreaking and highly successful welfare program initially created under the name *Progresa*, now called *Oportunidades*. Providing food, education, and health support, *Oportunidades* is a palliative, original in its approach and now copied elsewhere, but it is not a solution.<sup>27</sup> Help also comes from remittances sent by migrants who cross the border into the United States without documents. For the people involved, a longer-term solution usually requires getting somewhere else. When the Mexican negotiators agreed, when

NAFTA was negotiated, to the duty-free entry of corn from the United States after fifteen years, the expectation was that the interval was long enough for job creation in the cities where the rural migrants were expected to go. The Mexican experts estimated wrong, however; Mexico's economic growth was not high enough after NAFTA went into effect.

Even though Mexico has had some success over the past decade in reducing poverty, a significant reduction requires high growth sustained year after year. The case most often cited in Latin America is Chile, where the number of people living in poverty was reduced from 41 percent in 1987 to 17 percent in 1994. This sharp, rapid decline was attributed to economic growth. Mexico has been unable to reduce its level of poverty to this extent because of the lack of sufficient, sustained GDP growth for some twenty-five years. Income inequality runs on its own track, one that is not parallel to poverty. For example, even as Chile's level of poverty declined sharply after 1986, its inequality rose. The Gini index, named after the Italian statistician Corrado Gini, is the technique generally used to show the extent of inequality and permits making comparisons across countries. The Gini coefficient is obtained by measuring the deviation between income percentiles and the income received by these percentiles of the population; the difference is the Gini coefficient. The higher it is, the more unequal the society is in income terms. If the population percentiles and the income each received were identical, the Gini index would be zero. Mexico's index is high, but according to the International Monetary Fund, it is lower than in Argentina, Brazil, and Chile.<sup>28</sup>

In the OECD's *Latin American Economic Outlook 2008*, one of the issues examined is "fiscal legitimacy"—namely, the degree of confidence people have in the government's performance in collecting and spending tax revenue. The proportion of the population in Mexico in 2005 that trusted that taxes were well spent was a mere 15 percent. The study also examined how taxes affect the Gini coefficient. According to the report, the Gini coefficient in Europe was 46 before taxes and 31 after taxes. In Mexico it was 51 before taxes, but still 49 after taxes—that is, not much improvement.<sup>29</sup> (This 2008 publication was the first edition of *Latin American Outlook*, which probably has something to do with the fact that the secretary-general of the OECD is a Mexican named Angel Gurría. He assumed this post on June 1, 2006; prior to that, he had been Mexico's foreign minister and then treasury minister.)

An important impediment to economic growth and political legitimacy in Mexico has been the lack of equal justice under the law. This affects inves-

tors who are not confident that they will get a fair hearing if brought before a court of law. Individuals in Mexico keep their distance from police, magistrates, and judges. If robbed, police are not generally informed by the victims for fear that a second robbery will take place. It is not uncommon for police to stop people in cars on highways with a trumped-up charge, seeking a bribe and implying that the alternative is arrest; it is common for victims not to report this to the authorities because the bribe-seekers have impunity.

President Calderón addressed the justice issue in his campaign and then followed up with a yearlong public discussion on the subject between the government, congress, academics, and nongovernmental organizations. On March 6, 2008, the Mexican congress approved an amendment to the constitution to strengthen the judicial system. It included provisions to institute an adversarial system based on trials (although this will take eight years to fully implement) and the presumption of innocence until proven guilty. Evidence obtained through methods that violate human rights will be suppressed, a guarantee of legal representation is included, and a new national public safety system will be set up to coordinate the work of the various entities in the fight against crime. The constitutional amendment process in Mexico requires the approval of sixteen of the thirty-one states.<sup>30</sup> The amendment looks promising on paper, but it will take time to evaluate its effectiveness.

### **Governance in Mexico**

Mexico's transition in 2000 was remarkably smooth from what Mario Vargas Llosa, the Peruvian novelist and onetime political aspirant, has called a "perfect dictatorship" to what is today a democratic country. The change took place without violence. There were step-by-step concessions by successive administrations, a sort of setting the stage for the final action. Vicente Fox of the PAN was elected and routinely sworn in as president, thus ending the seventy-one-year presidential rule of the PRI, although not necessarily forever because the PRI may return to the top as the most competitive party. However, the alternation in power is no longer contested. That which had been barely possible now exists.

Effective democratic governance is not easy, and Mexico has little practice at it. The complexity of democracy, Mexican style, became manifest after 1997, when the PRI lost its majority in the lower house of the congress, possibly as a reaction to the country's deep depression in 1995. This was a watershed event in Mexico. The PRI president at the time, Ernesto Zedillo,

was faced with the reality that he had to bargain with the legislature to get his initiatives enacted into law. This was new in modern Mexico. Bargaining did not work well, in part because the two main opposition parties, then the PAN and the PRD (Partido de la Revolución Democrática, the Party of the Democratic Revolution) were intent on furthering their own interests, and in part because each party had to cater to powerful special interests that were important to it.

This is still the case. Vicente Fox, on the one hand, had practically no success in dealing with the legislature, where the opposition was the PRI and the PRD. Felipe Calderón, on the other hand, has shown that he is willing to bargain with the congress, and he had some successes in his first year in office. He had more difficulty in his second year as president, however.<sup>31</sup> The PRD is the party of Andrés Manuel López Obrador, who narrowly lost the presidency to Calderón in 2006, and the party is not inclined to bargain with Calderón on such issues as altering the structure of the energy sector, an important initiative in 2008. As one examines the inability of the authoritarian PRI presidents to obtain the structural changes needed for higher economic growth, even when the legislature was a rubber stamp, it is not surprising that this is even more difficult when power is divided between the executive and legislative branches. Mexico is a prime example of the way that special interest and rent-seeking groups retard national economic growth, famously analyzed in the United States by the best-known academic analyst on this subject, Mancur Olson.<sup>32</sup>

A November 18, 2006, survey of Mexico in the *Economist* concluded that the old political model had died and a new one had yet to be born. The many decades of strong presidents had turned into a time of weak presidents. A redundant congress had turned into a quarrelsome one. State governors had little national influence under the old system and were now important, perhaps in compensation for the weaker presidents. It might help if deputies and senators were allowed to run for reelection, perhaps for one more term for senators and two more terms for deputies (allowing both senators and deputies to hold office for a total of twelve years) to make them less dependent on their parties for their next jobs. However, even if this were to happen, it might not work out that way.

In the past Mexico has made major policy changes after crises. By about 1970 it was evident to Mexican economists that the postwar import-substitution policy had run its useful course, but the change to a more open economy did

not occur until after the economic crisis of 1982. The fixed-rate exchange rate system showed deep strain throughout all of 1994, but the change to a more flexible system took place only after the peso crashed at the end of the year, leading to economic depression in 1995. Many Mexican experts think that energy policy may go through a similar pattern should Mexico be forced to import oil, just as it now imports natural gas. It is hard to know what should be done to make Mexican democracy more meaningful. The likely answer is to allow time for this to happen.

One final point to make about Mexican democracy is to question whether the country's politicians are as enthusiastic about democracy as outsiders would like them to be. Mexico had established a federal electoral system (Instituto Federal Electoral, the IFE) and a separate tribunal to monitor elections and electoral activities. The system was dominated by an independent president and members chosen because of their distinguished backgrounds, and this structure worked well over several elections. Indeed, the IFE structure was superior to the party-dominated electoral monitoring system in the United States. The IFE played a central role in handling complaints from the PRD and its presidential candidate, López Obrador, in 2006. However, after the election, at the insistence of the PRD and with the support of the PRI, Mexico chose to make its monitoring body more like that of the party-dominated U.S. structure. President Calderón consented to this to get the necessary votes to pass the tax legislation discussed earlier. Many leading Mexican intellectuals protested the idea of making the IFE subject to the very political parties competing for election, but to no avail. Mexico must collect more taxes, but it also needs a strong electoral system. Trading away the latter for the former may turn out to have been an unfortunate deal.

## Problem-Solving Techniques

The rest of the book explores how the Mexican and the U.S. governments have approached each other (and still largely do) in their conduct of economic relations—the former as an overly defensive nation and the latter as one that is often excessively aggressive. These approaches have changed over time as the objective situation changes, but the vestiges of old habits are deeply embedded in their respective national characteristics. The premise from which this analysis unfolds is that these approaches are not optimal, and consequently often lead to suboptimal economic relations.

This does not imply that *all* economic interactions are of this defensive-aggressive nature. Mexico knows how to say “no” when an issue is important to it or is considered to be extremely sensitive, such as the refusal to negotiate any changes in oil policy in NAFTA. The Mexican authorities also know how to chip away at undesirable U.S. actions, especially when prodded by its private sector. Several examples of eventual solutions to trade disputes show this. The U.S. for many years imposed restrictions on Mexican avocados to prevent the transfer of pest infestation into the United States—restrictions that were legitimate in their time. The Mexicans worked on the problem and in the early 1990s convinced U.S. agricultural authorities to conduct joint annual surveys of pest incidence over four years. The surveys demonstrated that pest infestations were under control. But it took until 2007 to progressively open the U.S. market, because of the resistance of U.S. avocado producers to face fierce Mexican competition.

Another example is the long effort of U.S. tomato growers, especially from Florida, to prevent or limit the import of fresh Mexican tomatoes. This restrictive effort took various forms: U.S. Department of Agriculture marketing regulations demanding uniform size in any carton of fresh tomatoes; antidumping cases alleging that Mexican tomatoes were being sold at less than fair value in the United States; and agreements forced on Mexico for floor prices to limit price competition with U.S. tomatoes and also “voluntary” export restraints by Mexico.<sup>33</sup> Today, the market is largely open (and the Mexican tomatoes are largely vine-ripened).

Yet another example of an eventual solution to a trade dispute revolves around U.S. antidumping restrictions against cement exported to the United States by Cementos Mexicanos (Cemex). These restrictions were maintained for sixteen years, until 2006. Cemex is one of the largest cement producers in the world. In 2000 the firm actually bought the U.S. company that brought the original antidumping case. The restrictions were lifted because of cement shortages stemming from Hurricane Katrina in 2005, plus the supportive effort against the restrictions by the U.S. secretary of commerce.<sup>34</sup> In each case of these cases the Mexican authorities persisted, with the help of U.S. legal advice, and eventually prevailed. The Mexican private sector operating cooperatively with the Mexican government can be both persistent and patient when dealing with U.S. trade restrictions.

One question consistently comes up: Why doesn't Mexico simply ask for what it wants? The same question can be asked in reverse: Why doesn't the

United States always ask for what it wants? The reality is that there are some objectives that cannot be resolved by bilateral negotiations. The Mexican government should want the use of narcotics in the United States to be decriminalized as a way to curtail the enormous rents obtained by drug cartels precisely because they are peddling illegal products. Mexico, however, cannot formally make this suggestion; U.S. drug policy is made in the United States. The United States would like Mexico to maximize its oil exploration and production and, deep down, thinks this would best be achieved by permitting joint ventures between Pemex and foreign oil companies. But the U.S. government cannot say this because Mexico will make its own oil policy. Most Mexicans would be grateful for more aid from the United States along the lines used in the European Union to assist “backward” regions. Mexican authorities are reluctant to say this because they don’t know the conditions the United States would put on its foreign aid (this is precisely what happened in the Mérida Initiative, which is detailed in chapter 4). Countries have to be careful what they ask for; they might get more than they asked for, as the United States learned from its programs seeking temporary immigrants.

Problems in specific areas cannot usually be resolved in isolation from the general context in each country. James Jones, who was the U.S. ambassador to Mexico from 1993 to 1997, has made the point that there are deep knowledge gaps in each country about the other—especially in the United States—and this complicates the resolution of problems.<sup>35</sup> The current context in the United States, as well as that in Mexico, will certainly change, and understanding these changes will be crucial to more informed policymaking on both sides of the border.