Mexico, an Emerging Economy in the Shadow of the Superpower

David Recondo

"Poor Mexico, so far from God and so close to the United States," exclaimed the Mexican President Porfirio Diaz, early in the 20th century, alluding to the unequal balance of power between Mexico and its northern neighbour. Although exaggerated and dated, reflecting the era of US interference in Mexico's trade, politics and military affairs, Diaz's remark is revealing in that it highlights Mexico's fundamental identity as a frontier land. This state with a population of 107 million has a unique geopolitical and geocultural position which conditions its emergence. Geographically, Mexico is considered as part of North America, but historically and culturally it is linked to Latin America. As a frontier land it is both the meeting point and the buffer zone between the developing "Indo-Afro-Latin" South, which is also home to Asian and Arab minorities ass a result of transcontinental migration, and the hyper-developed North, home to the world's biggest economic and military power, to which it is inextricably connected by a land border of 3,300 kilometres.

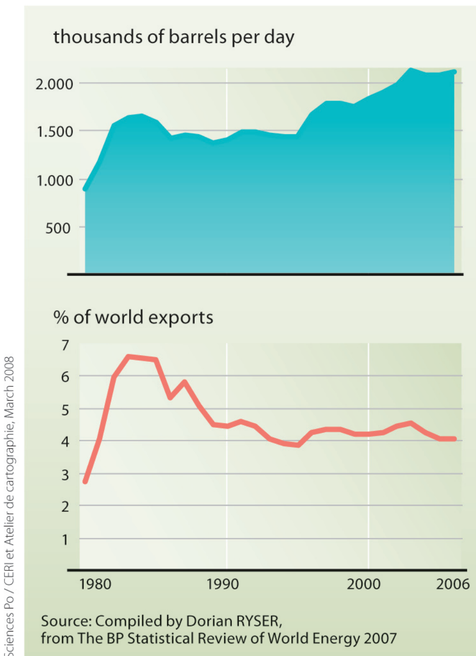
Apart from this geographical specificity, Mexico shares a number of characteristics with the other emerging countries: stable political institutions, a diversified export-led economy albeit dependent on the North's growth (essentially that of the United States), and a highly unequal distribution of wealth, with around 25% of the population living below the poverty threshold. Beyond these shared traits Mexico has two major differences from the other emerging economies: the key role of drug trafficking, and the phenomenon of migration towards the North.

The three drivers for emergence: the state, regional integration and exile

Mexico owes its emergence to three fundamental factors. Firstly, the political will of the post-revolutionary governments from the 1930s played a crucial part in diversifying Mexico's economic activities and enabling the country to become heavily industrialized. Within a few decades, Mexico progressed from being an essentially agricultural economy, with some export crops (coffee, sisal, tropical fruit), to an industrialized economy from as early as the 1940s. The late 1930s also saw the nationalization of oil (21 March 1938) and the establishment of the state-owned company PEMEX (Petróleos Mexicanos). The oil boom was to finance the country's industrialization on the "import substitution" principle developed as a model by the Economic Commission for Latin America and the Caribbean (ECLAC) in the 1950s under the guidance of the economist Raul Prebisch.

However, since Miguel de la Madrid's government (1982-88), the Mexican state has come to play a more modest role in the national economy which is beset by falling oil prices and a huge debt. Nonetheless, in the eyes of the other countries in the region, Mexico remains the leading promoter of economic development. Privatization of some sectors (banks, airline companies, road infrastructures, food industry, etc.) is relatively limited compared to that of other Latin American countries, starting with Brazil and Argentina; but the Mexican state does continue to support agricultural and industrial export activities, particularly through fiscal incentives and subsidies towards energy consumption. It also has a monopoly on the extraction, conversion and commercialization of hydrocarbons.

figure 28: **Mexico's oil exports, 2006**

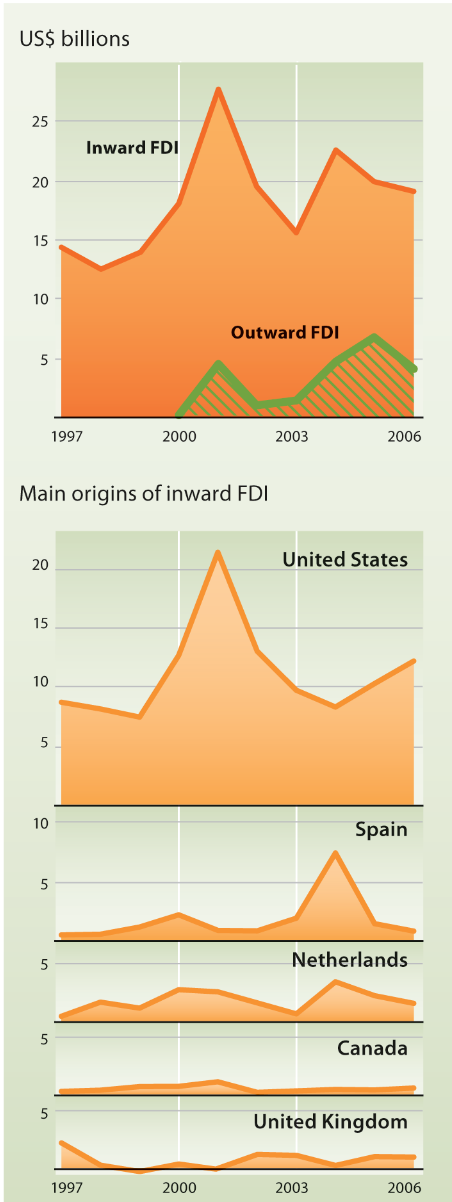


Source: Compiled by Dorian RYSER, from The BP Statistical Review of World Energy 2007

The second factor helping the Mexican economy become part of the global market is its integration into the North American market in 1994. Overall, the impact of the North-American Free Trade Agreement (NAFTA, signed in 1993 and inaugurated on 1 January 1994) has been good for the Mexican economy. The assembly industry and its associated activities saw strong development during the first decade of integration. The Agreement not only stimulated US industry relocations; domestic industry and the services sector also benefited from the removal of tariffs and other trade barriers. Exports of manufactured goods and agricultural produce and raw materials to Mexico's two northern neighbours increased exponentially. The figures seemed to contradict the doom-mongers who, after the neo-Zapatista uprising of January 1994 and the ensuing political and economic crisis, claimed that Mexico's entry into the "first world" was merely a trick on the part of President Carlos Salinas de Gortari (1989-94) and his gang of "Chicago boys".

The country entered the 21st century with public finance in a healthier state (the public debt is much lower than Brazil's, around 25% of GDP as against 50% for the giant of the Southern Cone), a steadily decreasing foreign debt and an increasingly diversified economy. The OECD considers Mexico to be a middle-income country, with a GDP of $10,700 per capita in 2007. However, there are two factors that tarnish the image of this success: on the one hand, Mexico remains one of the most inegalitarian countries in the world, with a Gini coefficient barely lower than that of Brazil (50.9 as against 56.7; that of the United States being 45), and with 26.3% of the population living on less than two dollars a day, according the World Bank data. On the other hand, the products which have driven growth since NAFTA came into force (textiles, toys, household appliances, etc.) are encountering fierce competition from the Asian countries. Mexico's prosperity has pushed up labour costs and allowed China to flood the local market and that of the USA with cheap goods. Beijing has superseded Mexico as the USA's second trade partner. And so Mexico now finds itself having to develop activities with a high added value and requiring a much greater investment in capital and training than has been made to date. The other side of the coin is Mexico's growing dependence on the US economy. At present, 80% of Mexico's trade is with its northern neighbour, further bearing out the old adage: "When America sneezes, Mexico catches a cold!" The slowdown of the American economy these last two years is probably largely responsible for the crisis hitting the Mexican economy, whose growth

figure 29: **Foreign direct investment (FDI) in Mexico, 1997-2006**



Source: Compiled by Dorian RYSER, from CEPAL, *Foreign Investment in Latin America and the Carribean 2006*

Sciences Po / CERI et Atelier de cartographie, March 2008 figure 30: **Trade between Mexico and the United States, 1990-2006**

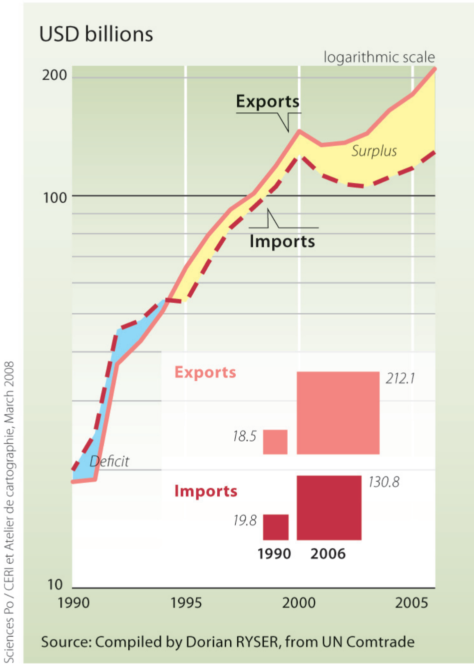
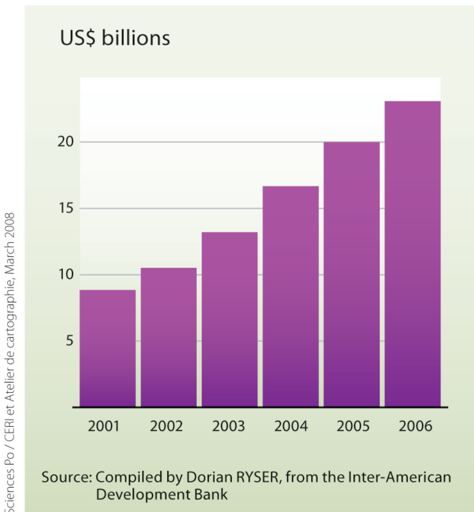


figure 31: **Remittances of Mexican migrants abroad, 2001-2006**



rate in 2007 (2%) was three times lower than the average for the rest of Latin America (6%).

Last but not least, the third driver for Mexico's emergence is migration, which is a well-established phenomenon since the first "*bracero*" labour programmes signed between the United States and Mexican governments, dating back to World War II. A more or less temporary northward displacement of the Mexican population rose to reach exceptional proportions within less than twenty years. According to official estimates, each year around one million people attempt to cross the border clandestinely, and half succeed. There are nearly 20 million US inhabitants of Mexican origin, more than 58% of America's Hispanic population.

The economic impact of this modern-day exodus is an acknowledged fact: nearly 25 billion dollars of remittances (*remesas*) were sent in 2007, the equivalent of half the value of the country's oil exports.

Millions of Mexicans rely more on these transfers from relatives working "on the other side" than on welfare assistance. This is a particularly significant case of "development through exile", with all the ambivalence such a notion implies. By guaranteeing a certain level of consumption and savings, the financial transfers make a major contribution to the emergence of the Mexican economy, while the mobility of surplus labour is a safety net that defuses the social and political tensions created by poverty. On the other hand, it is likely that over time the family and community ties will loosen and the transfers will end up being reinvested in the US market. Furthermore, a close sociodemographic analysis tends to show that the migrants are not necessarily from the poorest sectors of Mexican society. On the contrary, those who leave are the people who have a certain material and cultural capital which the Mexican economy partly loses to its two northern neighbours. More than ever, the symbiosis of Mexican and US societies is challenging the idea of Mexico as an independent power. Perhaps we will soon be speaking of the emergence of a "Mexamerican" power rather than seeking south of the Rio Grande a rival power to its uncomfortably close northern neighbour.

Democratic pluralism at the centre, authoritarian enclaves on the fringes

Although the Mexican economy experienced ups and downs in the 1980s and 1990s, the country's political stability has always distinguished Mexico from its southern neighbours. The transition from a regime led by one dominant party to competitive multiparty politics was smooth, almost without violence. And yet, the presidential election of 2 July 2006, with its extended post-electoral conflict, called into question the idea of Mexico as a fully-fledged democracy. For the first time in ten years, the institutions responsible for organizing the ballot and resolving disputes were seriously called into question. The left-wing opposition's accusation of widespread fraud is reminiscent of the dark years of election rigging by the Institutional Revolutionary Party (PRI), the dominant party from the 1930s until the transition years between 1977 and 1994. However, since the electoral reform of 1996 and the establishment of the Federal Electoral Institute (IFE) and the Electoral Tribunal of the Judicial Branch of the Federation (TEPJF), the elections have become genuinely competitive. This has enabled the right-wing opposition (National Action Party, PAN) and the left (Party of the Democratic Revolution, PRD) to win some ballots, first of all in the federal states and in the Federal District, then at federal level (in 2000 the PAN candidate, Vicente Fox, won the presidential election after 71 years of PRI rule). The extraordinarily close result of the 2006 presidential election (Felipe Calderón (PAN) with a 0.58% lead over Andrés Manuel Lopez Obrador (PRD), i.e. less than 235,000 votes out of 50 million) and the IFE's inefficiency led to mobilization of the left-wing candidate and his supporters, convinced that they were victims of election rigging. Andrés Manuel Lopez Obrador remained intransigent, driven by a messianic fervour; he refused to accept the results and proclaimed himself president. The credibility of the electoral institutions was seriously damaged; the opposition parties (including the PRI) did their utmost to obtain the resignation of the members of the IFE board and appoint their own members to this independent administrative authority, looking ahead to the federal legislative elections of 2009 and the presidential election of 2012!

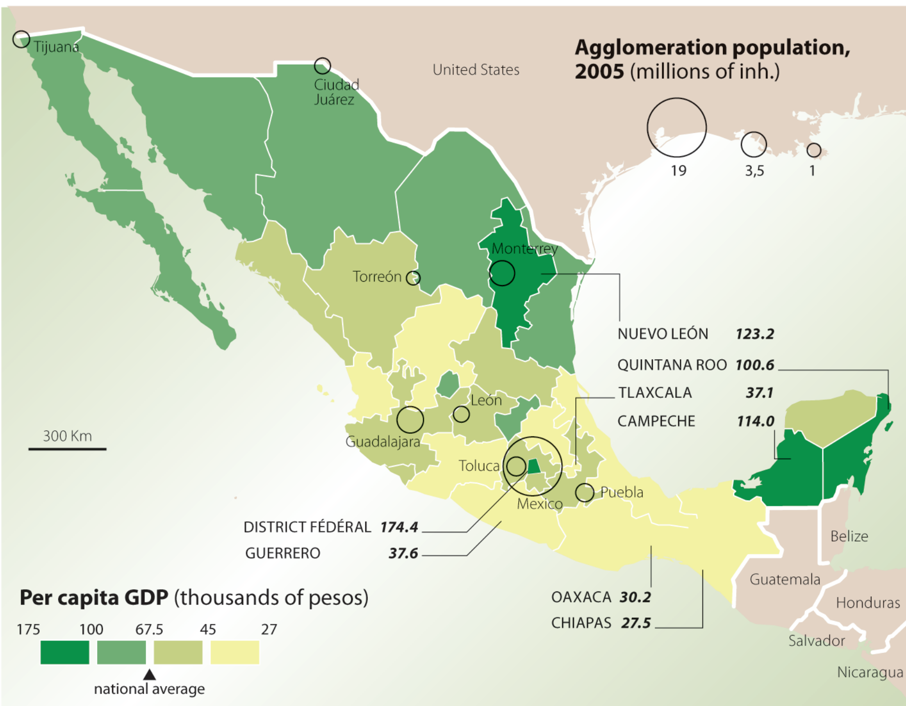
However, generally speaking, the Mexican political regime remains stable and the election controversy has not jeopardized the democratic order. Democracy is well and truly established after a very long transition from the regime of the dominant party, which had come to power in the late 1920s, to the multiparty system, which has only been in operation since the legislative elections of 1997, when the PRI lost its majority in the Chamber of Deputies and the PRD won the election for Mayor of Mexico City. Gradually, cohabitation between a government and a parliamentary majority of opposite tendencies is becoming a tradition after the presidential handover of 2000. Today, Congress is truly independent, the debates are lively and the agreements on proposed laws vary in nature. In short, the separation of powers is no longer a mere façade. Political debate and negotiation have also become a reality in most of Mexico's 31 states. The PRI continues to govern in more than half the states but only has a relative majority in some of them. The remaining states are divided between the PAN and the PRD, creating a geographically differentiated pattern of party support: in the south and in the centre-south of the country the PRI and the PRD dominate the electoral scene (except in Yucatán in the Maya peninsula), while the PRI and the PAN control the north and centre-north (except for Baja California South, which is governed by the PRD). However, the electoral landscape becomes much more complicated at municipal level: the PAN governs most cities, in both north and south of the country, in contrast to the early 1990s, when it was established predominantly in the cities in the north. The pendulum swing with each changeover is unquestionably the best sign that democracy is well and truly established in Mexico. In 2005, the PRI regained the industrial northeast state of Nuevo León on the US border, after more than a decade of the PAN being in power. The same thing happened in Yucatán in 2007.

One of the knock-on effects of the transition, in particular the swings in the north and north-west states in the late 1980s (Chihuahua, Baja California, Nuevo León, Guanajuato and Jalisco), and of the PRI losing its majority in Congress in 1997, has been the consolidation of the governors' power. As part of the decentralization process the state governments received financial injections from the Federation. Furthermore, the heads of the executive of the 31 states and of the Federal District are no longer controlled by an all-powerful president. In the past, the president had the power to dismiss them at any time. Now they are key political actors, often managing vast resources, not always lawful (some, including Roberto Madrazo, Governor of Tabasco from 1994 to 2000, and Mario Villanueva, Governor of Quintana Roo from 1993 to 1999, have been accused of accepting funding from drug cartels). Some observers see this consolidation of gubernatorial power as the sign of a return to the political order that prevailed from 1910 into the 1920s, when the revolutionary *caudillos* were the bosses and no one was strong enough to stand up to them, not even from Mexico City. The political crises like the one in Oaxaca in 2006 (violent repression of a protest movement led by the primary school teachers' union) reveal the strength of authoritarian enclaves beyond the federal government's reach. Even if political pluralism and guarantees of fundamental rights are becoming established at the national level, democracy is still very precarious on the fringes of the country.

Growing inequalities

The signs of an improved macroeconomic balance barely conceal a structural trend: the widening of social and territorial inequalities. Generally, the indicators show the extent to which a minority has been able to take advantage of the opportunities offered by the increase in trade with the United States. The assembly industry boom in the centre and the north of the country (*maquiladoras*) has harnessed a mainly urban population with a low literacy level, while the rural population has been hit harder by the lack of competitiveness of its agricultural produce compared with imports from North America. Furthermore, NAFTA puts Mexican products at a disadvantage, while the hefty subsidies the US government gives its own farmers have contributed to the deterioration of living conditions in the Mexican countryside. Additionally, the setting up of monopolies in some activity sectors (telecommunications, retail distribution) has contributed to the concentration of wealth in the hands of a few big groups and their employees, to the detriment of small and medium-sized businesses which have felt the impact of the lifting of trade restrictions. This has resulted in a two-speed development,

figure 32: **Per capita GDP of Mexican states and major urban agglomerations, 2006**



Source: Compiled by Dorian RYSER from Instituto Nacional de Estadística, Geografía e Informática (INEGI), Mexico

Sciences Po / CERI et Atelier de cartographie, March 2008 with “enclaves” that have succeeded in joining the global economy, and other parts that are lagging behind. This disparity is reflected geographically in a particularly graphic manner, with the country literally divided down the middle: the industrial north and centre have a GDP well above the national average (Aguascalientes, Queretaro, Mexico state and the Federal District), while in the south, all the indicators show a GDP more akin to that of Central America, except for the Maya peninsula (Campeche, Yucatán and Quintana Roo), which is boosted by domestic and international tourism.

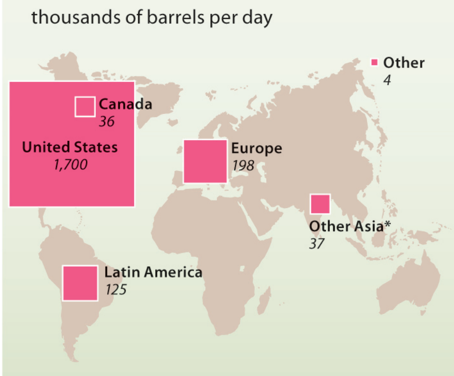
At the same time, in the big cities (Tijuana, Monterrey, Guadalajara, Mexico City and the metropolitan region), opulence and consumption of luxury goods exist side by side with extreme poverty. The latest models of American cars and “intelligent” buildings in the business districts contrast sharply with the ragged children selling chewing gum at traffic lights. But in these same towns, the territorial disparity is greater, with ghettos forming: the wealthy districts, on the one hand, surrounded by walls and barbed wire and guarded by private security firms; on the other, the “disreputable” districts or the “new towns”, mostly with solid buildings, but lacking in basic infrastructure (asphalt roads, electricity, running water, etc.). This scenario, familiar in other emerging countries, is relatively recent in Mexico (twenty years at most), where for a long time the post-revolutionary state ensured a certain social mix, and by promoting state education and industrialization, helped create a large middle class. Until the 1980s, only the very rich lived in exclusive districts. Now, the impoverishment of the middle classes goes hand in hand with the spread of poverty in the country’s cities.

Oil income: a poorly managed resource

The Mexican state nationalized the oil industry in March 1938. Within seventy years, PEMEX has become the world’s ninth biggest oil company, the third largest producer of crude oil and the twelfth biggest refiner of oil. Some 80% of crude oil exports are to the United States, Mexico being the second supplier after Canada.

The other side of the coin is that while 40% of state revenues come from oil, proven reserves will be exhausted within less than a decade. PEMEX, a real cash cow for the Mexican state, has not invested sufficiently in exploration to ensure further proven reserves and a reassessment of probable and potential reserves. With sales of nearly $100 billion in 2007, this oil giant does not have the resources to finance its modernization alone, because of the high taxes to which it is subjected. Furthermore, most of the potential new reserves lie deep under the waters of the Gulf of Mexico, where costs of exploration and exploitation are higher, and the company does not have the financial means for this in its present state. The main problem is the fact that PEMEX is run like an administrative department and not like a public company allowed a minimum of independence in planning its spending and defining and implementing its development strategies. The result of this fiscal and managerial servitude is not only a drop in PEMEX's output, but also the underdevelopment of its refinery and petrochemicals activities, whose products have a much higher added value than that of crude oil. As a result, Mexico is increasingly dependent on the United States, from which it imports nearly 25% of its domestic consumption of refined products.

figure 33: **Destination of Mexican oil exports, 2006**



*Other Asian countries excluding China, Japan and Singapore

Source: Compiled by Dorian RYSER, from BP, *The BP Statistical Review of World Energy 2007*

Over the last decade, the steadily rising price per barrel has only aggravated the situation, since it more than makes up for the drop in production. The fiscal reform of 2007 is not sufficient to remove the constraints that prevent PEMEX from increasing and diversifying its investments. Moreover, the constitution still prohibits any strategic alliance between nationalized industries and private companies (national or international) in any sector of the oil industry, from exploration to petrochemicals. But the nationalization of 1938 is such a potent symbol of the sovereignty of the Mexican nation in the face of interference from foreign powers, and of the state's determination to encourage industrialization by exploiting raw materials directly, that this issue is a political taboo. Since that date, any endeavour to open up the hydrocarbons sector to private investment is seen by public opinion as an attempt at privatization. The opposition—especially Andrés Manuel Lopez Obrador's PRD party—made the battle against privatization its key campaign issue, once the post-electoral conflict of 2006 was over. However, in April 2008, boosted by support of the PRI, President Felipe Calderón put before Congress a proposal seeking to allow PEMEX to enter into partnerships with private companies, for exploration, transport or refinery, but not allowing them a share in the risks or profits or a stake in the reserves. It is not certain whether that would be enough to make PEMEX a profitable company, nor even whether private companies want to take on all the risks with no stake in the hydrocarbon reserves. But even if such a reform were to be introduced, the state's dependency on oil revenues would still not be reduced. The illusion of a significant increase in reserves in the medium term prevents successive governments from seeking to diversify fiscal revenues and from reinvesting energy sector profits in the development of high-added-value sectors or in supporting other economic activity sectors.

Drug cartels: the power in the shadows

In addition to very unequal social and territorial development, Mexico's government is also undermined by the increasingly menacing presence of organized crime. Drug trafficking in particular has reached an unparalleled scale. Not only is the country the main route for drugs destined for the North American market (chiefly cocaine from Colombia but also cannabis, its derivatives, and, more recently, synthetic drugs), but for nearly a decade the Mexican cartels have directly controlled the introduction of drugs into the US market. The Colombian cartels are content to deliver the goods to the Mexicans and are seeking alternative outlets in Europe, via the Caribbean and West Africa. Mexico itself is also a major market, with cocaine consumption rising steadily since 1997, the year when the standard of living began to improve. The impact of trafficking is not only economic but also political. In this matter, the end of the dominant PRI regime was a determining factor. Effectively, the political influence of the drug barons, still barely visible in the 1980s, has been very much in evidence since the cocaine boom. However, unlike Colombia during this same period, a sort of non-interference pact between the executive and the main cartel bosses (mainly the Sinaloa cartel in the north Pacific) made it possible to prevent the mafias from infiltrating the state and federal government to a greater extent until the beginning of the 21st century. It is highly likely that in the drug producing federal states and/or drug trafficking hubs, narcodollars helped finance political life in the 1970s and 1980s. It is also likely that since the 1980s, presidential campaigns have been funded by dirty money. The immediate entourage of President Carlos Salinas de Gortari (1988-94) was accused of benefiting from laundered drug money. However, never have the cartels attempted, as in Colombia, to control entire sections of the national territory or to place their own men in Congress or within the Presidential cabinet. Contact has always been indirect and covert.

The change of president and the dismantling of the pyramidal, centralized political system constituted by the dominant PRI régime led to a sharp break in the relations between the cartels and the state powers. Evidence of the drug barons' growing political influence began to appear at the end of the 1990s. The increased independence of the judiciary, the introduction of an anti-corruption policy and the end of the law of silence guaranteed by the PRI's power monopoly also revealed the connivance between politicians and drug bosses. But it was above all the end of the non-interference pact and the proliferation of the cartels, and the rivalry between them, that helped to make drug trafficking visible and to push the war on narcotics to the top of the political agenda. The first president of the new regime, Vicente Fox (2000-6), sparked things off when he attacked the various drug trafficking operations in the Gulf head-on while treating those of the Pacific Coast more circumspectly. The outcome of this policy, carried out without first stopping to weigh up the situation, was a resurgence of turf wars between drug gangs vying to control the trade routes and the local markets. In 2006, Felipe Calderón took on all the cartels—those of the Pacific as well as the Gulf. This was a priority issue for him, and he entrusted the task to the army. The confrontation resulted in pitched battles in the northwest and northeast of the country (Michoacán, Sinaloa, Baja California, Nuevo León, Tamaulipas). A large number of soldiers and civilians were killed, and the government's policy of challenging the drug cartels head-on was strongly criticized by the political class and a section of the public. But the war between the organized crime gangs to control the drug trade caused more deaths than the army's operation. The hierarchy of the past, which allowed one cartel (chiefly the Sinaloa cartel) to rule, persisted for a long time; now the Gulf organizations were fighting those of the Pacific with commando forces (the *Zetas*), sometimes better equipped and trained than the army itself. The "cartel war" has claimed thousands of victims during the last five years.

The most optimistic view portrays the present government as keeping up deliberate ongoing harassment of the drug organizations while stoking their intrinsic rivalries in order to re-establish the monopolistic balance of the past, but the other way around (Gulf *versus* Pacific). Meanwhile, Mexico's cooperation with the United States' government with a view to halting arms dealing—which takes place mainly on the other side of the Rio Bravo—and to deal with the problem by trying to halt demand, has produced few results to date.

Translated by Ros Schwartz

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