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MEXICO IN CRISIS

The Parameters of Accommodation

Bruce Michael Bagley

FOREIGN POLICY INSTITUTE
SCHOOL OF ADVANCED INTERNATIONAL STUDIES
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1. Background of the Crisis
2. The Challenge to U.S.-Mexican Relations

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1. BACKGROUND OF THE CRISIS

Mexico is midway through the fourth year of its worst economic crisis in more than half a century. Not since the Great Depression of the 1930s has this key Latin American nation of almost 80 million inhabitants teetered so close to the brink of financial collapse. Indeed, with the precipitous fall of international petroleum prices in early 1986, such a collapse has never appeared more imminent. Many observers, both domestic and foreign, have begun to speculate that continuing economic austerity could disrupt the traditional "peace of the PRI" (Mexico's dominant Institutionalized Revolutionary Party) and set in motion a cycle of praetorianism and political instability that might ultimately bring the Mexican military into politics, a scenario often labeled the "South Americanization" of Mexico.

With the precipitous fall of international petroleum prices, a Mexican financial collapse has never appeared more imminent.

In light of the extensive interdependence that characterizes contemporary U.S.-Mexican relations, prolonged turmoil south of the border is not simply a Mexican affair, for it would severely damage vital U.S. economic and security interests as well. Both the Mexican and U.S. governments explicitly recognize that their respective national interests require active cooperation to avert complete economic collapse in Mexico. At issue are the terms of that cooperation. Discussion of these terms was a central topic on the agenda in the four-hour meeting between U.S. President Ronald Reagan and Mexican President Miguel de la Madrid Hurtado, held in Mexicali, Baja California, on January 3, 1986.

The asymmetries inherent in U.S.-Mexican interdependence inevitably confer an advantage in such bilateral negotiations on the stronger and more powerful United States. With the Mexican economy in crisis, the de la Madrid government entered these discussions virtually prostrate. During the talks President Reagan expressed his administration's willingness to provide economic aid to its troubled southern neighbor. Treasury Secretary James Baker, however, quickly proceeded to condition U.S. assistance upon less Mexican government intervention in the economy, greater reliance on private sector financing, and other internal economic reforms along the lines proposed in the so-called "Baker plan," first presented by Secretary Baker at the October 1985 International Monetary Fund (IMF) and World Bank meeting in Seoul, South Korea. In addition to these economic conditions, the Reagan administration also hinted that U.S. cooperation with Mexico on the economic front would be contingent upon intensified Mexican cooperation with the United States in narcotics control and on less vocal, lower-profile Mexican opposition to U.S. policies in Central America.

This policy brief explores the status of U.S.-Mexican relations in the wake of President Reagan's trip to Mexicali. To help locate this presidential "summit" in its proper context, the brief begins with a background to the current crisis and a sketch of its essential economic and political dimensions. It then examines how the crisis has affected both the priorities and relative autonomy of the Mexican state in the conduct of its foreign policy in Central America. It concludes with a look at the implications of the crisis for the United States and the possible course of U.S.-Mexican relations over the next couple of years.

FROM BONANZA TO BUST

The second round of OPEC-inspired petroleum price hikes in 1979 ushered in an unprecedented era of economic bonanza in Mexico.

Mexico's current economic crisis dates officially from August 31, 1982, when then-president José López Portillo (1976–82) was forced to declare a moratorium on his country's foreign debt repayments, devalue the peso by almost 100 percent, and appeal to the international financial community for a bailout. These drastic moves were the result of a complex set of international and domestic factors that converged in mid-1982 to drive Mexico into bankruptcy.

Upon taking office on December 1, 1976, president López Portillo himself had inherited a disastrous economic situation from his predecessor, president Luis Echeverría Alvarez (1970–76). In August 1976, hard hit by the 1973–74 oil price hikes, the ensuing 1974–75 world recession, and the Echeverría administration's own economic mismanagement, Mexico had been obliged to sign off on a three-year IMF austerity program (1976–79) in order to obtain an urgently needed standby loan from the Fund. Despite the gravity of the economic problems he left behind, Echeverría's legacy also contained two major assets for the incoming López Portillo administration. First, president Echeverría took it upon himself to negotiate a standby agreement with the IMF prior to his departure from the presidency, thus removing that onus from the new government. Second, Echeverría left it to López Portillo to announce that Mexico had recently discovered huge, new petroleum reserves, which almost overnight converted the country from a net importer into a major petroleum exporter.

On the strength of the new oil discoveries and strict compliance with an IMF stabilization program during 1977 and 1978, the López Portillo administration was able to turn the country's economic fortunes around by early 1979. In fact, the second round of OPEC-inspired petroleum price hikes in 1979 ushered in an unprecedented era of economic bonanza in Mexico. Bolstered by the nation's newfound oil wealth, in 1980 the López Portillo government was able to put forward an ambitious new "global" development program for the country—called the *Plan Global de Desarrollo*—that posited growth rates as high as 8 to 10 percent annually in some sectors during the decade. The intention was to "sow" oil revenues back into the national economy in order to achieve real economic takeoff in Mexico. Mexico's future had never looked brighter.

In the United States and other petroleum-importing nations, however, the 1979 oil "shock" produced economic slowdown (1979–80) and subsequent recession (1981–82). As a result, by the second half of 1981 world demand for petroleum slackened and prices slid downward, generating a growing shortfall between projected and actual revenues for the Mexican state. The López Portillo

administration did not readjust downward its economic growth targets but rather engaged in heavy international borrowing to finance its global development plan and its attendant fiscal deficits.

In retrospect this decision was a costly miscalculation on the part of López Portillo and his advisers. International interest rates, most importantly in the United States, rose explosively in the wake of the 1979 oil crunch and made such borrowing exceedingly expensive in 1980 and beyond. In effect, like the socialist Mitterrand government in France during the same period, López Portillo attempted to "grow out" of the deepening world recession rather than to retrench. In part, this decision was based on the not illogical assumption that the world economy, and thus oil prices, would not deteriorate as dramatically as it in fact did in 1981 and subsequent years. In 1980 and early 1981 most economic experts were still forecasting that petroleum prices would remain high throughout the decade. During this time the U.S. government, hoping to find a substitute for imported petroleum, had launched an ill-fated experiment with the manufacture of synthetic fuels—the so-called "syn fuels" project—based on a similar and equally erroneous assumption about the continuing high price of oil.

López Portillo refused to join GATT, contending that many small- and medium-sized national industries could not withstand competition from the United States and other multinationals.

By late 1981, however, it had become increasingly clear that the international economy was in for a prolonged bout of recession, yet López Portillo persisted in his expensive, anticyclical growth strategy and heavy international borrowing. This choice was a function of the president's domestic political exigencies, not of rational economic planning. In the year prior to the July 1982 presidential elections López Portillo sought to bolster the PRI's electoral image by following the time-honored Mexican tradition of "letting the patronage flow." To counteract three years of IMF-style austerity during the first half of his *sexenio* (six-year presidential term) and to satisfy rapidly rising popular expectations fueled by the country's oil boom, the López Portillo government continued to borrow from the international commercial banks on increasingly shorter terms at progressively higher interest rates. The money was used to subsidize domestic consumption (especially for Mexico's pampered middle class), to finance expansionary economic policies, and to underwrite growing government deficits. While feasible in the short run because the international banks remained willing to lend to oil-rich Mexico, such deficit spending could not be sustained indefinitely. By mid-1982, with the federal government's fiscal deficit projected to reach 17.5 percent of GNP (gross national product), with foreign reserves down to a paltry $700 million, and without the ability to continue borrowing from foreign banks, Mexico had literally gone broke.

High and continuously rising interest rates in the United States during the 1979–82 period exacerbated the López Portillo government's economic problems by encouraging massive capital flight across the porous U.S.-Mexican border into the more lucrative and risk-free capital markets of the United States. The administration's loose monetary policies allowed the Mexican peso to become overvalued vis-à-vis the U.S. dollar, making the purchase of imports relatively cheap and thereby worsening the nation's trade balance while making Mexican exports progressively less competitive.

In 1980 López Portillo refused to join the General Agreement on Tariffs and Trade (GATT), contending that many small- and medium-sized national industries

could not withstand exposure to competition from the United States and other multinationals—an infant industry argument tinged with Mexican economic nationalism. He was also convinced that Mexico could use its oil to gain access to U.S. and other developed-country markets even if Mexico did not join GATT. However, the deepening U.S. recession generated rising protectionist sentiment in Congress while it simultaneously reduced demand in the United States for imported oil. With Mexico's oil "weapon" blunted, increased protectionism in the United States and Europe further undercut Mexico's ability to export and thus to earn the foreign exchange needed to pay its international debts.

U.S. and European commercial banks also bear part of the responsibility for Mexico's 1982 economic debacle. During the late 1970s, flush with huge amounts of petrodollars, the commercial banks proved eager to lend to oil-rich Mexico. Indeed, from 1978 through 1980 they frequently competed among themselves, bidding down fees and spreads in order to establish a beachhead in the booming Mexican market. Charged with moving money, bank loan officers frequently did not examine the health of the overall Mexican economy very closely or the profitability of the specific projects for which the loans were made. In the euphoria of Mexico's oil bonanza the international banks never seriously questioned the Mexican government's creditworthiness.

The same "herd instinct" that led the commercial banks to lend so feverishly to Mexico during the boom years drove them to reduce their exposure once the economy began to founder.

After such collective profligacy in lending during the late 1970s and early 1980s the banks refused to extend any fresh credit once the deep fissures in the Mexican economy became inescapably apparent in early 1982. This, in effect, pushed Mexico into financial collapse. The same "herd instinct" that led the commercial banks to lend so feverishly to Mexico during the boom years drove them as a group to reduce their exposure once the economy began to founder, thus guaranteeing that Mexico would have to recur to an IMF standby agreement.

On September 1, 1982, the day after his moratorium announcement, president López Portillo used his executive powers to nationalize the country's entire banking system in a desperate effort to stem further capital flight. In the process he also nationalized some 40 percent of the shares of the country's major corporations held by the banks. These nationalizations were accompanied by vitriolic statements from president López Portillo accusing Mexican bankers and corporations of economic treason for sending their capital out of the country. The private sector, in turn, decried the nationalizations and López Portillo's import and exchange controls as statist and socialist responses to the economic crisis. The uncertainty created by the nationalizations further paralyzed the nation's economy.

It is ironic that López Portillo ended his *sexenio* denouncing domestic businessmen, foreign bankers, and U.S. economic policies for causing his country's troubles. López Portillo was a U.S.-educated "technocrat," and early in his administration his moderate, pro-business economic policies were viewed, at home and abroad, as healthy antidotes to those of his left-wing nationalist predecessor, Luis Echeverría. Packaged as an Alliance for Production (Alianza para la Producción) among capital, labor, and government, López Portillo's initial economic program sought to restore a positive climate for domestic and foreign investment by reversing the leftward and statist tilt of the Echeverría government's economic strategy and by strictly complying with its IMF

stabilization program. López Portillo's own shift leftward in the 1982 crisis was in part a sign of his frustration and disillusionment with Mexico's inefficient and highly protected business community and in part a calculated political move to shift blame for the nation's economic debacle away from his government and onto domestic and foreign capitalists as well as the Reagan administration's economic policies and attendant high interest rates.

López Portillo's own leftward tilt at home was paralleled by his government's assumption of an increasingly independent and activist foreign-policy stance in Central America, frequently at odds with the thrust of the Reagan administration's hard-line approach. Even prior to the July 19, 1979 triumph of the Sandinista revolution in Nicaragua, the López Portillo government had been openly anti-Somoza. Through the end of his *sexenio* in December 1982, president López Portillo was one of Latin America's most eloquent defenders of the Sandinista revolution and most outspoken critics of the Reagan administration's East-West approach to Central America.

During Mexico's oil bonanza political corruption registered quantum increases reaching into the hundreds of millions, if not billions, of dollars.

In Washington the Reagan administration made no effort to disguise its disagreement with the López Portillo government's domestic economic or foreign policies. Already strained as a result of Mexico's opposition to Reagan's Central American policies, the rift in U.S.-Mexican relations deepened further. López Portillo's nationalistic economic policies and rhetoric in the face of the crisis and his subsequent refusal to reach an agreement with the IMF added significantly to these strains.

Despite tensions between Washington and Mexico City, the Reagan administration quickly assumed leadership of the Mexican bailout effort. In September 1982 the U.S. Treasury Department provided a $600 million emergency line of credit for Mexico; the U.S. government then agreed to an advance of $1 billion against future Mexican oil deliveries to the Strategic Petroleum Reserve and to provide another $1 billion line of credit from the Commodity Credit Corporation for food imports from the United States. As a practical matter, Washington had no choice but to come to Mexico's aid in order to safeguard vital U.S. interests.

The U.S. government, along with Mexico's commercial bank creditors, did demand as a condition for further lending that Mexico reach an agreement with the IMF on an economic stabilization program. From late August through December 1, 1982, when he left office, president López Portillo negotiated with the IMF but steadfastly refused to sign off on an agreement on the grounds that IMF conditions were too onerous and violated Mexico's sovereignty. Like his predecessor, president Luis Echeverría, president López Portillo left his successor an economy in shambles. Unlike Echeverría, however, López Portillo did not leave Miguel de la Madrid Hurtado (1982–88) a signed IMF agreement. That burden was among the first that the new Mexican president had to shoulder after his inauguration on December 1, 1982.

The political legacy of the López Portillo *sexenio* has proven equally burdensome. During the country's oil bonanza political corruption registered quantum increases reaching into the hundreds of millions, if not billions, of dollars and touching even president López Portillo himself. Runaway patronage and

corruption bred cynicism and distrust of politics, especially among the more educated and affluent segments of the middle class. As the economic crisis deepened and standards of living eroded, the middle class in particular began to question the efficacy and legitimacy of the PRI-dominated political system.

MANAGEMENT OF THE CRISIS, 1982–1985

In mid-1982 Washington called upon the multilateral lending organizations to coordinate the Mexican economic recovery effort.

Once in office President de la Madrid quickly came to terms with the IMF, signing a standby arrangement on December 23, 1982. The traditional IMF stabilization formula required Mexico to reduce government expenditures in order to shrink the fiscal deficit, to tighten monetary policy in order to rein in inflation, to increase prices and taxes in order to increase government revenues, and to devalue the peso in order to increase exports and foreign-exchange earnings. By design IMF stabilization programs contract an economy. They are conceived as short-term (one- to three-year) corrective strategies, not as development programs.

The Reagan administration came to office in 1981 highly critical of the roles of multilateral lending organizations, such as the IMF and the World Bank. In fact, during its first eighteen months the Reagan government refused to approve any increases in funding for either organization, despite the deepening international recession and the looming Third World debt crisis. Confronted with Mexico's financial collapse in mid-1982, however, Washington abandoned its skeptical attitude toward these organizations, particularly the IMF, and called upon them to coordinate the Mexican economic recovery effort. The IMF assumed principal responsibility for monitoring Mexican compliance with the short-term stabilization program while the World Bank focused on medium- and long-term structural adjustment strategies to restore balanced growth.

During 1983 the de la Madrid administration strictly complied with the provisions of Mexico's IMF agreement. As a result, deficit spending as a percentage of GNP shrank from 17.5 percent in 1982 to around 10 percent in 1983. The 1982 trade deficit was converted into a record trade surplus of $14 billion in 1983 while inflation dropped from a runaway 100 percent to 80 percent. Compliance was not achieved, however, without significant costs. GNP contracted by 5.3 percent in 1983 while per capita income dropped by 8 percent in the same year.

While painful, such austerity measures prompted no major political protests, a testimony to the continuing strength of the PRI. Moreover, 1984 seemed to indicate that the IMF's bitter medicine actually worked. The Mexican economy rebounded in 1984 to post a respectable 3.5 percent growth rate. Inflation dropped to 59 percent. The fiscal deficit declined to 6 percent. With almost $18 billion worth of exports, Mexico was easily able to service its debt for the first time in several years. In 1984 the IMF, the commercial banks, and the Reagan administration all pointed enthusiastically to the Mexican example as a success story that should be emulated by other debtor nations in Latin America and the Third World. A clear sign of the commercial banks' approval was their decision in 1984 to reprogram principal payments on half of Mexico's debt for fourteen years. This rescheduling agreement was itself heralded by the international financial community as a model for solving Latin America's debt problems.

RELAPSE INTO CRISIS

Mexico's economic revival, however, proved short-lived. The multiyear reschedulings, in reality, eased the country's debt burden only marginally and temporarily. While principal payments (clearly unpayable anyway) were reprogrammed, interest payments were left untouched. Indeed, in 1986 just to service its almost $100 billion foreign debt (second largest in the Third World, behind only Brazil's $115 billion), Mexico will have to pay close to $15 billion—approximately 60 percent of the country's total yearly exports. Similar outflows occurred in 1984 and 1985 as well. Such high interest payments have converted Mexico into a net exporter of capital, leaving the country with little to invest in economic recovery. Such payments are neither economically nor politically sustainable in the long run.

Petroleum exports account for almost three-quarters of Mexico's desperately needed foreign-exchange earnings and 45 percent of tax revenues.

Exports in 1986 are not likely to generate the foreign-exchange earnings needed to help pull the Mexican economy out of crisis. Demand for Mexican products in the all-important U.S. market will probably be disappointing, due to relatively slow growth in the U.S. economy (2.5 percent) projected for 1986. The steadily declining price of oil—Mexico's key export, which accounts for almost three-quarters of its desperately needed foreign-exchange earnings and 45 percent of tax revenues—promises to dip even lower in 1986, pushing the country even closer to bankruptcy.*

Mexico's economic growth rate in 1985 was only a dismal 1 percent (well below the population growth rate of 2.4 percent) while inflation reached 60 percent (versus an IMF target of 35 percent). Draconian austerity measures since 1982 have translated into an almost 50 percent decline in real wages for most Mexicans while rates of underemployment and unemployment now hover near 50 percent. Projections for 1986 suggest zero growth, with inflation likely to exceed 1985 levels.

The September 1985 earthquake that devastated Mexico City has forced additional burdens on the national budget. Reconstruction is estimated to cost at least $3 or $4 billion. Reportedly, the winter tourist trade was also substantially affected. Simply to service its debt Mexico will need in the neighborhood of $4 billion in new lending in 1986. The very day of the earthquake, however, the IMF had announced that, because of the de la Madrid government's deviations from its IMF standby agreement, no further disbursements would be made to Mexico until the necessary economic corrections had been undertaken. Only after the news of the seismic disaster did the Fund reinstate Mexico temporarily.

In order to obtain the $4 billion in fresh money the country so urgently needs in 1986, the de la Madrid administration now finds itself in the decidedly uncomfortable position of having to negotiate a new package of austerity measures

*With 50 billion barrels of proven reserves and a daily production of 1.44 million barrels in 1985 (down from 1.53 million barrels per day in 1983 and 1984), Mexico is the world's fourth-largest oil-exporting nation. The country's most recently posted prices of $26.25 for light crude and $22 for heavy are about $5 above January 1986 spot market rates and are likely to fall significantly over 1986. In fact, some analysts believe the world price of petroleum could drop as low as $15 per barrel by 1987. Mexico's 1986 budget is premised on a world price of $24.50 per barrel. Each dollar per barrel drop in the price represents a loss of around $550 million in anticipated foreign-exchange earnings.

(for example, tighter monetary policies, reduced subsidies, and higher taxes) similar to those that plunged the country into deep recession in 1983. Even if these new resources prove forthcoming, as seems likely, the new borrowing will provide only temporary relief while compounding the underlying debt problem. Mexico's debt time bomb continues ticking louder than ever.

Several factors combined account for Mexico's relapse into debt crisis in 1985. In anticipation of the July 1985 midterm elections for state and local offices the de la Madrid administration, a year before the elections, moved to inflate the economy through stepped-up government spending. This politically motivated shift to a more expansionary economic strategy widened the fiscal deficit and kicked inflation above IMF targets. These premature deviations from the austerity program forced the IMF in September 1985 to declare Mexico out of compliance with its standby agreement and to announce a cutoff of further disbursements.

Real interest rates remain at record-high levels and each point costs Mexico approximately $800 million a year.

Consistent with the patrimonial character of the Mexican regime, de la Madrid's 1984–85 budget excesses incorporated liberal amounts of patronage for key PRI constituencies around the country. Although considered politically necessary, such PRI largesse further aggravated the nation's economic situation. Despite his widely publicized anticorruption campaign, during his first three years in office de la Madrid was ineffective in reining in the rampant corruption characteristic of the Mexican system. Again, hundreds of millions, if not billions, of dollars were siphoned off from the national budget.

While domestic political pressures, bureaucratic inefficiency, patronage, and corruption are important factors in Mexico's current relapse into debt crisis, many of the country's economic problems are the result of external factors beyond the government's control. Although international interest rates have moderated somewhat in the last two years, real interest rates remain at record-high levels; each point costs Mexico approximately $800 million a year. Elevated interest rates in the United States have also continued to encourage capital flight out of Mexico and have made Mexican efforts to repatriate the approximately $50 billion of Mexican capital in the United States very difficult.

The continued decline of petroleum prices on the world market costs Mexico dearly. Although Mexico is not a member of OPEC, Mexican policymakers have been reluctant to break ranks with official OPEC pricing policies. PEMEX, the state-owned petroleum company, lost a billion dollars or more in oil sales in 1985 when it hesitated to lower prices below OPEC guidelines, even as many OPEC countries were doing so.

A relatively low 2.4 percent growth rate in the U.S. economy in 1985 combined with increased protectionism in the United States and Europe to reduce Mexican nonpetroleum exports in 1985. Mexico's own complicated system of protectionism has nurtured an inefficient industrial sector, which cannot compete in international markets even under the best of market conditions. Under current, slow-growth conditions Mexican industry is simply not in a position to mount an effective export-oriented growth strategy.

The politics of the current Mexican crisis are as bleak as the economics. The prospect of additional years of austerity, on top of the three past years, dismays

the Mexican people and has eroded the PRI's political-electoral support. The PRI's political hegemony has historically rested on a combination of "revolutionary myths" inherited from the 1910 Mexican Revolution, a delicately balanced system of clientelism and patronage politics, electoral fraud, and the selective application of state repression against un-co-optable opposition groups. Well before the economic collapse of the 1980s the legitimacy of the country's inclusionary authoritarian regime had come under increasing attack from disaffected segments of the middle and working classes as well as business for its ingrained corruption, cronyism, inefficiency, and fraudulent electoral practices. Although the Mexican system will most likely remain stable, the additional stresses generated by prolonged economic austerity over the 1980s could conceivably provoke a full-blown legitimacy crisis and open the way for progressive militarization of the Mexican political system. As former foreign minister Jorge Castañeda has recently commented

Prolonged economic austerity could provoke a full-blown legitimacy crisis and open the way for progressive militarization of the Mexican political system.

> The political system as a whole has already lost the support of the prosperous, "developed" segments of Mexican society. It is no longer truly representative of key social strata such as lawyers, doctors, accountants, lower-income clerks, shopowners and even some local bureaucrats and industrial workers. They may be equally disenchanted with the existing opposition, but they no longer believe in the government or look to Mexico City for the solution of their region's problems.
>
> Losing the votes of these key sectors does not necessarily mean that the PRI will lose power on a national level through electoral defeat, but it does represent a serious weakening of the PRI's long-standing dominance. This trend calls into question the viability of a one-party monopoly of political power. There is a growing cleavage separating the modern, northern, urban, more affluent Mexico, where the PRI barely receives a plurality or a slight majority of the vote, and the backward, southern, rural and poorer Mexico, where it continues to rack up 80–90 percent of the vote. The PRI rules both Mexicos as if they were one; they are not. Such a situation eventually seems untenable without coercion. And somewhere along the line coercion implies the military; everyone knows how its involvement begins, but no one ever knows how it ends.*

*Jorge G. Castañeda, "Mexico at the Brink," *Foreign Affairs*, vol. 64, no. 2 (Winter 1985/86), 291–92.

2. THE CHALLENGE TO U.S.-MEXICAN RELATIONS

IMPLICATIONS FOR THE UNITED STATES

Viewed from Washington, Mexico's present crisis constitutes a major foreign-policy problem. U.S. interests in Mexico range from trade and investment to security concerns. Mexico is the United States' principal foreign supplier of petroleum, having supplanted Saudi Arabia in 1983. It is also the United States' third-largest trading partner, behind only Japan and Canada. U.S. business has directly invested roughly $15 billion in Mexico, and U.S. banks hold more than half of that nation's outstanding commercial debt. A Mexican economic collapse would, therefore, cause massive disruption in the U.S. economy and the entire Western financial world. It would also increase the already sizeable flow of economic refugees from Mexico into the United States (1.5 to 2 million in 1985) and might well generate a new category of Mexican refugees fleeing increased political repression in that country.

A Mexican economic collapse would cause massive disruption in the U.S. economy and the entire Western financial world.

Potential political instability in Mexico also conjures up major security concerns for the United States. Conservatives see Mexico as the ultimate target of Soviet expansionism in the hemisphere; they fear that Mexico may become the "final domino" in the row of Central American dominoes that began falling with the Sandinista revolution in Nicaragua in 1979. In reality, a right-wing military intervention to restore political order and economic growth and prevent a left-wing revolution would appear to be a much more plausible scenario if political breakdown was ever to occur. Although neither scenario appears at all likely in the foreseeable future, both alternatives represent undesirable outcomes from the U.S. perspective. A pro-Soviet regime in Mexico City is almost unthinkable for reasons too obvious to require further comment. A right-wing takeover would be only slightly more acceptable, for it would openly violate democratic principles, probably be very repressive, and quite likely prove far less stable than the regime that it supplanted.

The current crisis has enhanced U.S. leverage over Mexican domestic and foreign policies substantially. Positive U.S. votes in the IMF and the World Bank are indispensable to Mexico's economic recovery because of the dominant role played by the United States in both multilateral organizations. U.S. backing is also useful to Mexico in its negotiations with the international commercial banks. Because of the overwhelming importance of the U.S. market to Mexico, the Mexicans are vulnerable to U.S. trade restrictions, such as "voluntary"

quotas, countervailing duties, and tariffs. Finally, Mexico needs U.S. investment capital and technology to modernize its inefficient industrial sector.

The Reagan administration is clearly intent upon using U.S. leverage to force Mexico to bring both its economic and foreign policies more in line with those of the United States. There are, however, limits on both Mexico's willingness to accept conditionality and on the United States' ability to insist upon it. In particular, if the austerity measures and other internal economic reforms required to qualify for international assistance are judged to be too onerous, Mexico could choose to default unilaterally or to engage in collective default with other Latin American countries, rather than to repay under such conditions. The Reagan administration must also be careful not to insist on economic and foreign-policy concessions that might destabilize the existing regime. Within these wide parameters, however, the Reagan administration presently finds itself in an extraordinary position to exact concessions from the de la Madrid government on both the economic and foreign-policy fronts.

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THE REAGAN-DE LA MADRID "BORDER SUMMIT"

The U.S. and Mexican presidents routinely meet once a year to discuss bilateral issues. Because scheduling conflicts prevented them from doing so in 1985, the fourth meeting between Reagan and de la Madrid was not held until January 3, 1986. The site chosen was Mexicali, Baja California, just across the border from Calexico, California. The proximity of these two towns led the U.S. press to label the meeting as a "Border Summit."

The Mexican economy's relapse back into debt crisis in 1985 brought President de la Madrid to the half-day meeting in search of the Reagan administration's support for Mexico's plans to borrow at least $4 billion in 1986 from the IMF and the World Bank as well as U.S. and other foreign commercial banks. Acutely aware of U.S. unhappiness with his country's domestic economic policies and its pro-Nicaraguan foreign policy in Central America, during the months leading up to the meeting de la Madrid maneuvered publicly and privately to defuse U.S. criticism and patch up relations with the Reagan administration.

Economic Issues

In the economic arena, as early as mid-August 1985 President de la Madrid formally undertook liberalization of his country's restrictive trade policies by signing a new understanding with the United States on subsidies and counterveiling duties. He also pledged that his government would slash the nation's resurging budget deficit by reducing featherbedding in the swollen public sector companies and by eliminating government subsidies to consumers (primarily in the areas of foodstuffs and transportation) and to industry (mainly in the areas of raw material imports and energy). De la Madrid also took pains in the months prior to the Mexicali meeting to express his government's interest in attracting new foreign investment to Mexico. Mexico has traditionally been leery of foreign, especially U.S., capital and has strictly regulated its entry into the country. The 1973 foreign investment law, for example, permits

non-Mexicans to own more than 49 percent of a locally incorporated company only in "exceptional" cases. De la Madrid's public statements on this subject were designed to signal the White House and foreign entrepreneurs that the government would interpret existing laws more flexibly. The Mexicans' 1985 acceptance of 100 percent ownership by IBM in a major, new computer venture seemed to confirm this new flexibility. Although only small steps, these reform measures are symbolically important because they reversed the country's forty-year tradition of protectionism, which had turned the economy into a "nightmare. . . of protectionism, inefficiency, massive subsidization. . . and technological backwardness. . . hamstrung by excessive red tape involving everything from foreign investment to import permits, and from export taxes to land tenure."*

Just a few weeks prior to the "Border Summit" de la Madrid took the much bolder, and potentially far more contentious, step of announcing that his government would affiliate Mexico with GATT. Ever since López Portillo's 1980 decision not to join GATT the United States has continually pressured Mexico to reverse its position and move toward freer trade. The Reagan administration and the U.S. Congress have become adamant in recent years that Mexico lower its tariff and nontariff barriers or suffer the consequences in terms of more severe U.S. sanctions and countervailing duties. The timing of de la Madrid's decision was designed to preempt further U.S. criticism of Mexican protectionism at the Mexicali meeting.

A few weeks prior to the summit de la Madrid announced that his government would affiliate Mexico with GATT.

Foreign-Policy Issues

In the realm of foreign policy, a month prior to the summit President de la Madrid delighted the White House with the announcement that Mexico would lower its activist profile in Central America. This declaration, first made in a personal interview in *Excelsior* in early December, and subsequently amplified by senior Mexican spokesmen, represented a major symbolic concession to the Reagan administration, for since the July 1979 Sandinista revolution Mexico had been counted among the Sandinistas' principal supporters in Latin America.

Between 1979 and 1982 the López Portillo administration provided approximately $100 million in direct technical and economic assistance to the Sandinista regime, far outstripping any other Latin American donor. The 1980 San José Accords between Mexico and Venezuela, which offered to supply nine Central American and Caribbean countries—including Nicaragua—with petroleum on concessionary terms, made oil a large and strategic component of the Mexican aid package. However, in early 1985 the de la Madrid administration sharply cut oil deliveries to Nicaragua. The public justification for this cutoff was the Sandinistas' failure to pay Mexico for its oil. The underlying reasons appear to have been growing disillusionment with the increasingly hard-line, pro-Soviet policies of the Nicaraguan government among de la Madrid's key advisers, combined with a desire to lower tensions with the United States over Central America. The Mexican government also sought to mend its frayed relations with the U.S.-backed government of José Napoleón Duarte in El Salvador during 1985 for similar reasons.

*Castañeda, *Foreign Affairs*, 296-97.

Under the López Portillo administration Mexico also sought to exercise diplomatic influence in Central America via joint initiatives, such as the August 1981 French-Mexican declaration on the Salvadoran conflict and the September 1982 Mexican-Venezuelan note on the Nicaraguan-Honduran border conflict. Along with such bilateral peace efforts Mexico also joined forces with other Latin American and Third World countries in international forums, such as the United Nations and the nonaligned movement (but not the U.S.-dominated Organization of American States) to cosponsor resolutions calling for negotiated settlements to the conflicts in Central America. Because these initiatives ran counter to U.S. hard-line, anticommunist policies in Nicaragua and El Salvador, they frequently pitted the López Portillo administration openly against the Reagan administration and caused severe strains in diplomatic relations between the two countries.

De la Madrid has shifted Mexican foreign policy away from unilateral and bilateral initiatives in Central America to the multilateral Contadora process.

With the transition from López Portillo to de la Madrid in December 1982, Mexican foreign policy shifted away from unilateral and bilateral initiatives in Central America to the multilateral Contadora process. By combining forces with three other Latin American nations—Venezuela, Colombia, and Panama—in the Contadora group, President de la Madrid hoped to augment Mexico's influence in Central America vis-à-vis the United States and, thus, to make a negotiated settlement in the region more feasible.

Within Contadora, for example, President de la Madrid effectively relinquished Mexican leadership of the Central American peace process to the dynamic, new president of Colombia, conservative Belisario Betancur Cuartas (1982–86). Despite this change in style, however, the de la Madrid administration has remained committed to the search for a negotiated settlement in Central America and behind the scenes has played a key role in directing the Contadora negotiations. Led by Foreign Minister Bernardo Sepúlveda Amor, the Mexicans have the largest and best-trained diplomatic corps and usually prepare the important background documents and chair the key technical meetings of the Contadora group's working committees.

The shift to a multilateral approach was accompanied by a lower-profile, less abrasive Mexican diplomatic style designed to defuse U.S. criticism of Mexico over Central America. From the outset of his *sexenio* de la Madrid has pursued an approach that has reflected his need not only to cure Mexico's internal economic problems but to preserve healthy bilateral relations with the United States. In addition, domestic opposition to López Portillo's close embrace of the Sandinista regime had blossomed among political conservatives from such right-wing parties as the National Action Party, among Mexican businessmen fearful of U.S. economic sanctions, and among military planners worried about the security of Mexico's southern border and possible spillover effects from Central America's civil wars.

Although de la Madrid did alter the modalities and the style of his predecessor's foreign policy in Central America, during his first three years in office he has remained firmly committed to the search for a negotiated peace in the region because he believes, as did López Portillo, that Mexico's national interests would be best served in this fashion. Prolonged warfare in Central America means that Mexico will continue to receive large numbers of economic and political

refugees that it can ill afford to host. Deepening turmoil also heightens the possibilities of direct U.S. intervention in the area—an eventuality the Mexicans have historically seen as threatening to their own national security. Finally, de la Madrid realizes that a precipitous move to the right on Central American issues could provoke harsh criticism of his government from the country's small but vocal leftist groups.

De la Madrid's pre-Mexicali revelations that he would spend little or no time on Central American issues in his upcoming discussions with President Reagan thus constituted an important departure from his previous insistence on the importance of Contadora as the way out of the Central American quagmire. While the Mexican president stated that his government would not withdraw from the Contadora process altogether, he let it be known that he felt that none of the parties involved in the conflicts in Central America—including both the United States and Nicaragua—was politically committed to a negotiated settlement. Under such circumstances, he claimed, very little was likely to be accomplished in Mexicali by dwelling on the Central American situation, especially when Mexico had far more pressing bilateral problems to discuss with the Reagan administration.

In return for U.S. assistance Mexico would be expected to cut government deficits, combat inflation, and promote private investment as proposed in the Baker plan.

Mexicali

Against this backdrop of prior Mexican concessions, the Mexicali summit was far more cordial and harmonious than any of the previous three meetings between these two presidents. On Central America de la Madrid ceremonially reaffirmed Mexican support for a negotiated settlement in Nicaragua while Reagan reiterated his belief that the Sandinista regime was the principal source of terrorism and subversion in the region. Neither president, however, chose to dwell on the topic and, in effect, both simply agreed to disagree on the issue.

In terms of Mexico's economic problems President Reagan praised the de la Madrid government's "strenuous efforts" to cope with the country's severe crisis and promised U.S. help to solve Mexico's financial problems. At the same time key U.S. advisers made it quite clear that, in return for U.S. assistance in persuading private banks and international lending institutions to make fresh loans to Mexico, the Mexicans would be expected to put their own economy in order by cutting government deficits, combating inflation, and promoting private investment as proposed in the the Baker plan.*

President de la Madrid responded by lauding the Baker initiative as an important "step forward" and the "starting point for imaginative, efficient formulas" for addressing the debt crisis. From the Mexican perspective the significance of the Baker plan lies in its recognition that the U.S. government would have

*First presented at the October 1985 IMF/World Bank meeting in Seoul, South Korea, Secretary Baker's proposal called for $20 billion in commercial bank lending to Third World debtor nations over the 1986–89 period to furnish the resources needed to repay existing debts and to invest in economic recovery. The commercial bank loans would be complemented with a $9 billion increase in World Bank lending during the same period. The internal economic reforms required by the plan were left purposefully vague, but all focused on less state intervention and greater reliance on market incentives and on foreign investment as engines of growth.

to assume a more active role in managing the Third World's debt problems. Prior to the unveiling of the Baker plan in October 1985, the Reagan administration had clung to the notion that the debt crisis was a problem for the debtor nations and their bankers to resolve among themselves. Following the summit, Mexican Treasury Secretary Jesús Silva Herzog labeled the Baker plan as "constructive, positive, and useful," but hastened to add that it did not provide "the definitive solution" for the debt burdens of either Mexico or the Third World.

A final important issue on the summit agenda was bilateral cooperation in the area of drug enforcement. In early 1985 U.S.-Mexican relations reached a low point when a U.S. Drug Enforcement Administration agent, named Enrique Camarena, was murdered in Guadalajara by drug lords and Mexican authorities failed to investigate the case vigorously. U.S. authorities pressured Mexico to push ahead with the case by staging vehicle-by-vehicle searches on the border that brought cross-border traffic to a virtual standstill. In the aftermath of the Camarena killing and ensuing U.S. pressures, Mexican cooperation with the United States on the narcotics front improved noticeably. At the Mexicali meeting President de la Madrid even unveiled a proposal for a "law enforcement summit," at which the attorneys general of various Latin American countries would meet with U.S. authorities to coordinate efforts to combat international narcotics trafficking. This proposal was enthusiastically embraced by President Reagan, who expressed U.S. appreciation for Mexican cooperation in the fight against drugs.

The significance of the Baker plan to Mexico is its recognition that the U.S. government would have to assume a more active role in managing Third World debt problems.

BEYOND MEXICALI

Although the Mexicali "Border Summit" produced no visible progress on any of the major issues between the United States and Mexico, it did reflect a warming trend in U.S.-Mexican relations, at least at the rhetorical level. Nevertheless, the friendlier tone achieved in Mexicali should not be allowed to obscure the persistence of critical differences between these two neighbors on issues ranging from Mexican domestic economic policies through immigration and drug trafficking to Central America.

One area that is likely to go "critical" very rapidly is the debt issue. The Baker plan simply does not provide enough debt relief to resolve Mexico's economic crisis. In exchange for their lower profile in Central America and their cooperation in the drug enforcement area, Mexico is likely to bargain for considerably more debt relief than that contemplated in the Baker plan.

The issues of trade and protectionism are also likely to remain important sources of conflict between the United States and Mexico for the foreseeable future. Although de la Madrid has committed his government in principal to GATT, the details of Mexico's entry will entail lengthy and difficult negotiations and will likely provide Mexico a ten-year grace period to complete the process. In the next few years the Reagan administration will have to struggle mightily in the U.S. Congress to avoid new protectionist measures against Mexico.

Mexico is currently being praised by the Reagan administration for its campaign against narcotics. Drug-related corruption has, however, by no means

been eliminated, and new tensions and scandals are likely on both sides of the border as the drug traffic continues to grow. U.S. praise of Mexico on this front has given way to bitter criticism in the past, and the same cycle is likely to be repeated in the future.

Despite Mexico's lowered profile in Central America at the outset of 1986, the conflicts in that region continue to simmer and could well flare up again at any time. Mexico's national interests are as much at stake in the region as are those of the United States; hence, it is unlikely that the de la Madrid administration will remain quiescent on this issue for long, especially if events within Central America breathe new life into the faltering Contadora process.

The health of the Mexican economy is, however, likely to remain the critical bilateral issue on the U.S.-Mexican agenda. The de la Madrid administration has begun to undertake some of the structural adjustments necessary for long-term economic recovery in Mexico. Without greater international assistance, though, it is unclear that Mexico will have enough time to implement them. Heavy-handed U.S. insistence on "privitization" and the "magic of the marketplace" could easily become counterproductive by irritating Mexican economic nationalism.

The Reagan administration will be required to commit resources—well beyond levels being contemplated in the Baker plan—to help stave off a Mexican collapse.

Mexico's desperate economic situation will become unmanageable—no matter what austerity measures the government takes—if the world price of petroleum continues to plummet on international markets over the next year. This crisis demands urgent attention from the U.S. government, for vital American interests are involved. The Reagan administration will undoubtedly be required to make a major commitment of resources—well beyond the levels currently being contemplated in the Baker plan—to help stave off a Mexican collapse. The United States cannot afford *not* to act.

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