



# MEXICO MATTERS:

Change in Mexico and Its Impact  
Upon the United States

LUIS RUBIO



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The United States is overlooking a real economic and political success story in Mexico. Our southern neighbor is going through a transformation of historic dimensions, yet a large gap remains when it comes to U.S. public perceptions of Mexico, which are too often breathtakingly simplistic views of drugs and migration combined with an un-American belief in building walls and exclusion.

Mexican society has undergone a deep change during its decade-long process of democratization. The country has enjoyed strong macroeconomic growth, and this year its GDP is growing faster than that of the United States. But the crucial dimension of Mexico's hidden success story is the rise of a middle class that is younger, more educated, wealthier, healthier, and more able to integrate women into the labor force than any previous generation.

—MICHAEL WERZ

# Foreword

Mexico is vital to the United States, as what happens there impacts us. Geography has joined these two nations and has forced us to reach out and understand each other.

There is no question that a healthy and prosperous Mexico is in our best interest. A prosperous Mexico means more American exports and more jobs for Americans. Understanding what happens in Mexico is critical for the U.S.

Twenty years ago, Mexico came to the realization that its fate was inevitably tied to that of the United States, and began to liberalize its economy and democratize its politics to get closer to its neighbor. It took the bold step of proposing a free trade agreement with the United States. The result was the North American Free Trade Agreement (NAFTA), the cornerstone of the democratization and liberalization process. Twenty years later it remains the gold standard for successful trade agreements. It has helped make Mexico our second-largest trading partner and a key link in many production chains. The ties that bind the two countries are profound and growing stronger every day.

Today, both the United States and Mexico face difficult dilemmas and challenges, most of them related to the basic issues of life like jobs, incomes and economic growth. It makes sense to see Mexico as a partner in these issues. There may be an opportunity to think about these jointly.

Many Mexican issues and problems affect us and many of our actions and decisions impact the Mexicans. We must understand better how these issues evolve and develop solutions that work to our mutual benefit.

This book presents a series of perspectives on what is happening in Mexico. It dwells on the sources of change that motivated Mexico to move to reform its economy and the political consequences of the decisions it has made. It explains the security challenges that Mexico is facing and the intricacies of its politics. The book is an outstanding overview on what is happening there from a keen observer.

Luis Rubio, a long time analyst of our two societies, has written a highly readable, and yet profound, analysis of Mexico and its complexities. We are certain that this book will help Americans understand our neighbor much better.

**CONGRESSMAN JIM KOLBE**

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It would be blind sight to hide the obvious that contemporary Mexico demands profound and responsible reorganization, a reorganization that conducts a cleansing of all the ends of the knot, and not only one.

—JOHN WOMACK

# I. Prologue

Somehow reform plans for the Mexican economy went astray. It wasn't supposed to be like this. The plan was to reform the Mexican economy to reach high and sustainable rates of economic growth, thus averting the need for political reforms or, lo and behold, a democratic election. Thirty years later the picture looks very different, but the root causes can be found in a botched reform process that has not been corrected even today.

Americans see Mexico through various prisms, often with little understanding of the nature and nuances of the depth and complexity of the changes that Mexicans have had to withstand and endure. Like all other humans, Mexicans want no more than a chance to live a peaceful and productive life. In the absence of opportunities to accomplish this in a normal way, they have had to resort to all sorts of actions and responses that Americans often misunderstand, such as migration to the U.S. or entering into the informal economy in their own country.

Mexicans are not corrupt by nature or by culture. Corruption stems largely from two sources: (1) a rapacious political system designed to control and serve the interests of the political bureaucracy; and (2) the complexity and ambiguous nature of the laws and rules, designed to confer extraordinary discretionary powers to those same bureaucrats. Cumbersome rules and arbitrary powers make life difficult for the average citizen and, in that context, corruption constitutes a rational response to avoid interminable hassles of daily life. In those cases where rules are clear-cut, such as the situation with imports and exports when these were liberalized in 1985, corruption is practically non-existent. Liberalization of imports led to the shrinking of the Ministry of the Economy, which went from more than 30,000 employees to fewer than 3,000; in the absence of rules to be interpreted and applied as the bureaucrats saw fit, corruption vanished.

Other than bureaucratic fiat, Mexico's biggest source of corruption today is related to the vestiges of the old political system that was never replaced by a modern, functioning democracy. The entrails of the political system are still plagued by what Mexicans call "de facto powers," meaning private

interests with virtual veto powers over issues that interest them, in all walks of life. The same is true for the weakness of the institutional structures, a legacy of a political system that worked around “strong men” whose powers were (and are) derived from personal control of mechanisms, instruments and contingents of various kinds. In short, corruption is directly correlated to weak institutions and lack of checks and balances. It is not Mexicans who are corrupt: it is the lack of strong and predictable institutions, bound by proper checks and balances, which creates a corrupt milieu. This is undoubtedly Mexico’s greatest challenge.

Similarly, Mexico’s problems of crime and violence are symptomatic of the country’s political structure and historical priorities. On the one hand, Mexico’s geographic location and the American demand for drugs make Mexico an inevitable transit point for drugs into the U.S. On the other, and much more important, the root problem for Mexico is not the existence of drugs, but the absence of a properly functioning and consolidated state. Mexico’s problem is one of police and judicial incapability, which has brought the state to its knees. Mexico never had a professional police and judicial system. What it did have throughout the greater part of the 20th century was an authoritarian political system that controlled everything, including criminality. The Institutional Revolutionary Party (PRI) constructed an authoritarian system that was able to withstand the challenges of its time and which—from the 1930’s through the mid-1960’s—brought stability, economic growth and an incipient middle class. However, the PRI system was incapable of running a modern country. A key question as the PRI takes power once more is whether this situation has changed.

This short book is an attempt to offer an explanation from a Mexican perspective of the way Mexico has been changing, albeit reluctantly, over the past few decades, often taking one step forward and two back, or vice versa. Despite the violence of late, Mexicans have experienced significant improvement in their living standards, freedom of expression is virtually absolute, and government officials are elected in clean and, in all but one case, broadly respected elections. At least half of Mexicans are today middle class and they enjoy access to all sorts of consumer goods, many of them imported from the United States and sold through chains like Walmart and Costco.

Despite these improvements, the evolution has not been straightforward or trouble free. At the core of what has ensued in the country in the past decades was the contradictory attempt to dismantle parts of the old PRI system without affecting the interests of its key stakeholders—clearly an impossible task. Any change or reform inevitably affects people and interests; otherwise, there would be no issue. The very idea of reform involves changing the status quo and that, by definition, involves modifications in the distribution of costs and benefits.

For almost four decades, from the 1920s through the 1960s, Mexico's economy grew at a sustained 6 percent, with very low inflation. By the late '60s, however, it had reached its limits and required reforms. Unfortunately, those in power opted for government spending and foreign debt as the means to foster growth, at an enormous cost in terms of both economic stability and domestic peace. By the early '80s, the country had gone broke. Reform had become all but inevitable.

The reforms started with modest changes in various sectors. Some government-owned corporations were privatized, imports were liberalized, and regulations were relaxed. By the late '80s, the country was in reform mood and the process sped up. Unfortunately, the rationale for reform was political. The overt objective was to reform the economy to avoid having to alter the political status quo. Hence, reforms, as profound as many were, operated within limits that often thwarted their avowed objectives. Also, the very technocrats that were promoting the reforms had contradictory objectives themselves. The most obvious of the attempts to avoid altering the political status quo were the “hands-off” approach to energy, a Mexican sacred cow, as well as to services. Among the reforms that were actually carried out, such as the privatization of major government-owned corporations starting with telecommunications, the criteria that prevailed was maximizing state revenues and not the development of competitive markets inside de economy. In effect, competition was minimized.

Political reforms followed a different path. While economic reforms were thought out as a proactive project aimed at transforming the country, political reforms were reactive and as unambitious as opposition parties or other political forces allowed. In stark contrast with other democratic transitions in nations such as Spain, South Africa or Chile, there was neither a

long-term vision for the development of a modern and democratic polity, nor a willingness to consolidate a new structure of power. The shaky nature of Mexico's political institutions today attests to this legacy.

The book consists of seven short chapters. The first positions Mexico as a fundamental issue for the United States. The second delves into the origins of the country's current situation and choices. The third analyzes the conundrum of the nation's politics. The fourth describes the process of decentralization that overtook the country in recent decades and what that entails for decision making. The fifth explores the economy, where it comes from and how it has performed, as well as its current dilemmas. The sixth examines the issue of security and its complexity. The book ends with a few thoughts on the stakes and opportunities looking toward the future.

## II. Mexico Matters

Mexico matters much more to the future of America than do Afghanistan or Iraq. Mexico is confronting a complex mix of challenges that will influence and, actually, change the United States. In the past few years, Mexico has emerged successfully from a profound recession, its government is confronting the drug cartels and its political system is far from consolidated. Because each of these challenges could constitute a direct threat to the U.S., it is important to understand what Mexico is and where the nation is going.

Mexico's stability is crucial for the U.S. Although the alleged spillover of violence has proven to be a myth (some of the safest American cities, like El Paso, lie at the very border), the fact that Mexico experiences instability of any sort constitutes a risk and a challenge for the United States. However, this need not be the case. This does not mean that the U.S. could or should take an active and decisive role in fixing its neighbor's problems. In fact, as the last several years have proven, there is relatively little, other than support, that the U.S. can do to help Mexico address its security issues. The neighborhood calls for new ideas, new ways of looking at problems. Among these, one possibility that should be considered is that the NAFTA region become a major export powerhouse to compete with Asia, given the relative strengths and weaknesses of each of its members.

Whether and how Mexico succeeds in resolving its current difficulties will have an extraordinary impact upon the U.S. The current wave of violence and insecurity has affected investment (at the very least it has reduced its potential) and lack of investment has impacted economic performance. These constitute powerful incentives for people of all socio economic backgrounds to emigrate. If Mexico were to resolve its challenges, it could turn around to become a formidable partner for economic growth. Either way, the evolution of Mexico's predicament will affect the United States in fundamental ways.

Mexico's stability is of great import to the U.S. and will affect the latter regardless of what occurs elsewhere in the world. Many of the most serious challenges to the stability of the North American region can be found in Mexico. At the same time, many of the opportunities for a truly competi-

The border between Mexico and the U.S. is political and historical, not geographical. The Rio Grande does not separate, it unites... To cross the border between the two countries is to change civilizations... Our attitudes toward time clearly express our differences. Americans overvalue the future and venerate change; Mexicans cling to the image of our pyramids and cathedrals, to values we suppose are immutable and to symbols that, like the Virgin of Guadalupe, embody permanence. However, as a counterbalance to their immoderate cult of the future, Americans continually search for their roots and origins; we Mexicans search for ways to modernize our country and open it to the future. The history of Mexico since the end of the 18th century has been the struggle for modernization. It is a struggle that has been frequently tragic and often fruitless.

—OCTAVIO PAZ, *TIME*, MONDAY, DEC. 20, 1982, "MEXICO AND THE U.S.: IDEOLOGY AND REALITY"

tive North America lie in combining American technological might and the progressively more productive and competitive Mexican manufacturing base. Mexico is critical to the U.S. and its dilemmas and issues will strongly influence the way the U.S. evolves.

## **TOO MUCH ABOUT DRUGS**

Nearly everything Mexican is interrelated with the U.S. and, yet, the two are very different. Mexico's history is important and rich, but its present and, above all, its future, are intimately connected to what takes place in the U.S. Domestic politics moves in one direction, but the Mexican people move in a different fashion. Drugs, migration, and an increasingly incompetent government narrate a very compelling story or, rather, collection of stories, as outlined by a former high official of the Mexican government's law enforcement apparatus:

When Catherine tried cocaine for the first time, she surmised, as do most people, "Nothing will happen." She became a recreational drug user who thought she would have a good time and would be able to "keep everything under control." Catherine married John, and together they enjoyed a successful upper-middle-class U.S. lifestyle in Los Angeles, California. Soon their beautiful little daughter Jenny was born. Prior to the current financial crisis, Jenny appeared to have her future assured, but economic problems and conflicts between Jenny's parents increased. Both lost their jobs and began to survive on part-time work. Stress grew. There was a divorce. After a few months Catherine's recreational cocaine use became an addiction that took control of her life. Divorced, unemployed, in debt, and burdened with both a young daughter for whom she had to provide and an addiction to maintain, Catherine started down the road to social and moral disintegration, a path that would be difficult to alter.

Sam, a young African American, grew up in a poor, violent neighborhood in Baltimore, Maryland. When Sam was a young child, his



father abandoned him and his mother, who attempted to teach Sam the difference between right and wrong. But, she was required to dedicate more time to work than to Sam. Soon the street became Sam's playground and their poor neighborhood, which was dominated by gangs, his learning slate. Sam saw that gang members were feared and respected, that they enjoyed privileges, had expensive clothes, and drove fancy cars. Like any adolescent, Sam felt the need to belong and to feel powerful. Soon, as did many of his friends, he joined a gang. One day Sam was offered the job of selling cocaine in the fancy neighborhoods of Baltimore. Sam accepted the offer, thinking "nothing will happen; I can walk away whenever I want." But one day when Sam's gang challenged a rival gang for control of the strategic drug-selling area, Sam was seriously wounded during a shootout that left him disabled for the remainder of his life.

Pedro was a Mexican truck driver with a transborder trucking business based in Ciudad Juárez, Chihuahua, on the U.S. border with El Paso, Texas. He was well respected in his neighborhood and much loved by his wife and children. With the business boom brought on by NAFTA, Pedro was able to buy three more large trucks and to improve his standard of living. For many years, Pedro successfully resisted the temptation to smuggle cocaine in his trucks headed for the U.S. Some of his fellow truck drivers had done so, and Pedro observed how they became rich easily. After a couple of years, the drug cartels had controlled Ciudad Juárez and the pressure to conform turned into intimidation. Finally Pedro succumbed to the pressure and temptation and, with the assurance of the protection of the cartels, allowed cocaine to be smuggled in his trucks into the U.S. He convinced himself by thinking, "Nothing will happen. I'll just do it a few times, and then I'll quit." Years later, the cartel's drug lords decided to use Pedro as a decoy to distract the authorities and allow a very important shipment of cocaine to slip by the border security. Pedro was betrayed by his own "protectors," arrested, and is now serving a long sentence in a federal penitentiary.

Álvaro was a Colombian campesino (peasant), the owner of a ranch blessed with fertile soil. For years he grew fruit and coffee, and raised cattle. He was neither rich nor poor. Álvaro was from a large family with deep religious roots. He was devoted to his family and had little or no interest in what was going on around him. He knew that the Revolutionary Armed Forces of Colombia (FARC, its acronym in Spanish) and paramilitary right-wing guerillas bases were nearby, and that some of his friends grew coca plants—a big business. Álvaro had managed to stay on the periphery and to coexist with a war that did not involve him. From time to time, he heard of clashes and killings. One day, an old friend in dire straits asked him to lend him a few acres to grow coca plants; Álvaro consented to help his friend. Soon he was sharing in the profits, thinking «Nothing will happen; it's just a small piece of land, I can control this.» But time proved him wrong. The war intensified. His home was destroyed by the combatants. His land was rendered infertile by the anti-coca fumigation. Álvaro and his family had to abandon everything they had. Today they live in poverty as refugees in Bogotá.

Catherine, Sam, Pedro, and Álvaro represent people caught in the trap set by the four stages of the drug cycle: consumption, distribution, trafficking, and production. These people are fictitious, but their stories represent reality for thousands of Americans, Mexicans, and Colombians. Which deserves our empathy and compassion and which merits our disgust and condemnation? Who is guilty and who is innocent?

The truth is that we are confronted by a shared tragedy that obliges us to accept a shared responsibility. We can resolve the drug problem only if we confront the problem together, and not attempt to blame the other or to feel sorry for ourselves. Not all Anglo Americans are addicts by nature. Not all African Americans are criminals, nor are all Mexicans corrupt, nor all Colombians violent. We are confronted by a common problem in societies with distinct economic and social developments, with unique institutional entities, and with disparate processes of law and order.

Simplistic approaches divide us, keep us ignorant, and afford advantages to criminals. The drug cycle reproduces, feeds, and multiplies itself

efficiently and viciously. The drug cycle procreates human tragedy, greed, violence, crime and death. Drugs destroy the lives of those who consume them, they feed upon the street gangs that distribute them, they arm dangerous cartels that traffic them, and generate bloody wars among those who cultivate them. Catherine's U.S. dollars finance the violence that leaves Álvaro impoverished and homeless; Álvaro's Colombian coca plants bring about the addiction that will end in Catherine's death. Drugs have both a homicidal and a suicidal logic.

Catherine represents the search for new «highs» and diversions among the economically well-to-do urban middle class. Sam, Pedro, and Álvaro represent those who desire to escape from poverty as quickly as possible. Indeed, all these people are victims of our materialistic society in the pursuit of what is defined by society as success. When vanity, luxury, and money comprise the central values of a society, greed becomes the engine of organized crime and the motivation for armies of poor people to succumb to and engage in criminal activities.

Recently we all witnessed the manner in which a formidable financial system could cause one of the most serious international economic crises of the past 70 years. Poor regulations and the greed of the individuals involved have thrown millions into unemployment and poverty worldwide. By the same token, greed drives the drug business, within the U.S. gangs as well as among the Mexican and Colombian cartels that are overwhelming us with corruption, addiction, and death. The question is how can these societies find ways to strengthen their social fabric and values and to generate self-control and an ability to build a different future?

Mexico is currently suffering from an explosion of violence that has shocked the whole world. Mexicans have not experienced such violence since the 1910 Revolution. Why and how did this occur so suddenly? How could this monster have been hiding for so long? How did the cartels become so powerful? What does this mean for the U.S.?

Mexico has not always been the main drug-trafficking route into the U.S. The most profitable, most rapid, and most geographically logical route was always by way of the Caribbean. That route allowed Colombian cartels to export drugs, first marijuana and then cocaine, directly into the U.S. without the need for intermediaries—think Al Pacino in the film

“Scarface,” or the “Miami Vice” television series. However, toward the end of the 1980s and the beginning of the 1990s, the U.S. was successful in closing the Caribbean through-trafficking route with a concentrated drug interdiction force. Colombia then experienced what could be called its first great war against drug trafficking, a war that resulted in over 70,000 deaths in Medellín alone.

The history of Colombia’s drug wars is critical to Mexico for it was the Colombian government’s success in those efforts that transformed the nature of the drug business in Mexico. In the past the entire chain from production to distribution in American cities was dominated by Colombians; once the Colombians were subdued, the Mexican mafias took over. This was a major factor in transforming Mexico into a key piece in the puzzle of the drug trade. Moreover, this was happening precisely when Mexico was experiencing significant political and economic turmoil.

### **THERE’S MORE TO MEXICO...**

But security is not Mexico’s only issue. The country has been undergoing a profound process of political and economic change and, yet, has been unable to accomplish its desired transformation. The country’s old autocratic political system is gone, but its democracy continues to be frail. Its economy has been split in two: on the one hand, a modern, competitive, and export-oriented industrial base; on the other, the inward-looking and unproductive remnants of an old era of sheltering domestic producers of goods that could be bought more cheaply from overseas.

The scars of this unfinished economic and political transition can be noted everywhere. This example says it all: the old Ramírez auto-parts factory was founded in the early 1940s when the WWII war effort in the U.S. forced Mexicans to produce their own manufactured goods. Germán Ramírez’s grandfather bought a set of well-worn machines from a German industrialist and began producing auto parts. The venture was an immediate success. As the war came to an end, Mexico adopted an import-substitution policy and began protecting producers such as the Ramírez family. The company manufactured springs for engine carburetors and soon became a

prime supplier to the local General Motors assembly plant. The son of the founder, Gonzalo, went to engineering school, and the grandson, the current chairman of the company, holds a master's degree from a Midwestern university. The business thrived and the Ramirez family became quite wealthy and accustomed to a life of luxury. The company became a cash cow rather than a challenge. Not surprisingly, the third generation of the Ramírez heirs saw no reason to change things. They continued to manufacture springs, even though modern engines no longer include a carburetor, not realizing that they had come to the end of the line. GM stopped purchasing from them and all they were left with is a dying spare-parts market. Worst of all, they did not understand their plight.

The experience of the Ramirez family is not unique in Mexico. They are merely an example of the way many Mexican companies became accustomed to a protected market and never learned to compete. Equally revealing is that, despite import liberalization, NAFTA, and other traditions and practices, some activities and sectors remain de facto protected or, at least, isolated from market forces.

Many of the country's political parties follow a similar story line. Shielded from the people through devices such as no reelection (for any elected position), the political parties entertain an interest in preserving themselves, increasing the transfer of monies from the public coffers, and hindering competition. Formally, Mexicans are represented in the political domain by their representatives in the Congress and in the Senate. However, both chambers are controlled by party bosses, who negotiate on behalf of party interests or those that the parties represent. Mexican democracy thrives at the voting booth, but it also ends there.

### **MEXICO'S ECONOMY AND POLITICS ARE OPEN AND, YET, NOT TRULY OPEN.**

The consequences of unfinished economic and political revamping can clearly be observed in the streets of U.S. cities in the form of Mexican migrants. Mexicans immigrate to the United States in response to the demand for labor deriving from the U.S. But their migration would not

exist, or would not be as great, if Mexico had succeeded in restructuring its own economy to create new and sufficient opportunities for job creation at home. As obvious as it may be, this is only one of the many ways in which the evolution of domestic issues in Mexico exerts an impact on the U.S. Contrary to U.S. myth, illegal immigration in the U.S. is not a Mexican problem; Mexicans, like Salvadorans and Chinese and all previous waves of immigrants into the U.S. respond to economic incentives and move to the U.S. because there are better opportunities there than in their home country.

Here's a typical example that shows the market-driven immigration story. I met Rodrigo when preparing a speech at a resort hotel in Puerto Vallarta in the Pacific. He was overwhelming in his willingness to make my dinner special. I wanted to eat quickly to get back to my room to finish preparing my talk. But Rodrigo would not let go. He kept offering me more food and drinks. I finally gave up and began chatting with him. It turned out he was from the Atlantic Gulf coast state of Veracruz; the majority of his relatives, including a brother, lived and worked in California. He was in Puerto Vallarta because he had learned from his relatives' experience. He wanted to learn the trade, and become an experienced waiter, so that he would not start as a server low in the restaurant hierarchy. A little over a year later, he sent me an email: he was now working at a small luxury restaurant in the Napa Valley. He was making "big" bucks.

Rodrigo represents a new breed of Mexican migrant. They no longer wait for opportunities, nor do they respond to the first call of their relatives in the U.S. They prepare themselves, develop better skills, and then, only then, they cross the border. They have learned that prior preparation pays off handsomely. They also know that the current recession is temporary. Years of experience has taught them that there is only one labor market in North America, and that borders are only one more obstacle in an increasingly integrated regional economy.

Interestingly enough, Mexico's demographics will soon end the immigration story. The population bubble of the 1980s is coming to an end and within a very few years there will be no more surplus labor to export. A combination of better standards of living (in fact, a rapidly growing middle class), effective population-control campaigns, and more women in the

## ILLEGAL IMMIGRATION IS DECREASING—FAST!

Hispanic immigration has long been a sore issue in American politics. While Mexican and other illegal migrants perform jobs that the market demands (in fact, unemployment among illegal immigrants is virtually zero, which means that this is a “perfect” labor market where supply matches demand), the existence of immigration creates inevitable realities that impact the body politic. Many Americans reject illegal immigration outright because by definition, it entails breaking the law. Others are concerned about the long-term impact of such a large foreign population in the midst of America. Perhaps nobody has articulated this perspective as well as the late Harvard professor Samuel Huntington, who argued that Hispanics “threaten to divide the United States into two peoples, two cultures, and two languages.”

Beyond the ideological and political disputes that are inherent to illegal immigration, the reality is that facts on the ground are changing fast. After years of growing rapidly, illegal immigration from Mexico is down. In fact, the so-called undocumented Mexican population in the U.S. is shrinking. All sorts of explanations have been provided for this phenomenon, the major two being that (a) as the American economy has shrunk, so has demand for the kind of labor that the undocumented typically provide, and (b) wage differentials between Mexico and the U.S. have made the trip to the north less attractive. While both explanations are based on relevant data, there is a third explanation that, in the long run, trumps all others: Mexican demographics.

After growing at about 4.5 percent per year for decades in the first half of the 20th century, Mexico’s population experienced a temporary increase in its rate of population growth during the 1970s, a fact that, in the long run, created a de facto “surplus” population of about 15 million people. Surplus because no structural changes in the economy were undertaken to match the growth of the population, thus creating a potential unemployment bomb. It is not surprising that that this figure matches nearly to the decimal point the number of Mexican migrants to the U.S. in the following decades.

What did change in Mexico during the 1980s and afterwards were the country’s population policies, all geared to rapidly lowering the rate of population growth, to the degree that during the last few years the population has been growing barely at replacement level (1.8 percent). Though the absolute population will continue growing, the surplus phenomenon is over. Mexico is beginning to age, just as have most other nations. With or without a U.S. economic slowdown, Mexican migration would have plunged very quickly.

None of this changes the fact that some 12 million illegal migrants live in the U.S., including some 6 million Mexicans, but it does indicate that the nature of the phenomenon, at least as it pertains to the U.S.-Mexico bilateral relationship, is undergoing radical change.

labor force have radically altered the demographic picture. Mexico's population is growing barely at replacement level. Americans soon will have to adjust their vision of Mexico as well as their rhetoric on this subject.

## **MEXICO AND THE UNITED STATES**

Mexico's geographic location might have been a blessing, but the country's many fears and myths kept it distant from the U.S. For more than a century after the "Mexican War," Mexicans were taught to see the U.S. as a threat to their country's territorial integrity. During the 20th century, the Institutional Revolutionary Party, PRI, saw the U.S. as a scapegoat for Mexico's ills and nurtured an inward-looking vision to sustain its legitimacy. It was not until the 1980s that Mexico decided to shift gears and approach Washington. This was a daring move; from Mexico's perspective, the country was turning toward a historical adversary, a move tantamount to dealing with its historical enemy. As the U.S. became part of the solution to Mexico's problems, huge internal transformations ensued.

Americans might have seen Mexico's approach as a natural thing to do. After all, it makes sense to become closer to the largest market in the world economy and to join in an effort that would enhance the welfare of the people. But Mexicans were emerging from 70 years of permanent manipulation. The PRI era had been benign compared to the era of Stalinist hard rule, but it was as pervasive and ubiquitous in peoples' minds. Mexicans were virtually trained to hate the U.S. and to blame it for even the most ludicrous of the country's ailments. Breaking away from that mold, presenting the U.S. as a solution rather than the old canard of the U.S. as the source of the country's ills, buying the notion that the country can actually benefit from closer ties with the U.S., required not only phenomenal diplomatic skills, but also exceptional leadership.

Now, however, the countries are linked, and not solely through NAFTA. The huge U.S. economy has drawn millions of Mexicans northward, creating social, cultural, and political ties, as well as border problems, between the two states. And the huge U.S. appetite for drugs has created a vast and illegal industry in Mexico, which is now



so large and contentious that the drug cartels are engaged in an open war against what Mexicans call “the state.” With this as a backdrop, Mexican politics has morphed into a dysfunctional system in which the old PRI regime has not been effectively replaced with new institutions or with an effective reform of the political system. And that is where Mexico is today, on the one hand halfway between economic and political well-being, and on the other, at the risk of violent lawlessness and slippage of reforms.

### **THE ENDLESS CONUNDRUM: FORWARD OR BACKWARD**

The challenges that Mexico confronts are multiple, but the most important have to do with its dysfunctional political system and the onslaught of the drug mafias, both of which translate into poor economic performance, migration to the U.S., and a permanent potential for instability. Mexico’s stability is of great importance to the U.S. and will affect it regardless of what takes place elsewhere in the world. A stable Mexico constitutes both a natural market for American products as well as a safe frontier. From this perspective, Mexico’s welfare is critical to the U.S. as American governments have long understood.

The North American Free Trade Agreement has been Mexico’s only true source of modernity and economic success in the past two decades. NAFTA also has signaled an opportunity for the North American region to compete against a growing Asian-region economy, becoming part of the solution to Mexico’s problems by aiding the country in its transformation to a major producer of manufactured goods with American parts and technology. By adding Mexico’s comparative advantages to the U.S.’s technological prowess, Mexico now could become part of the solution to the current economic situation in the U.S. Clearly, becoming close to the U.S. through NAFTA has caused profound review of the country’s history and recognition that Mexico is part of North America and that the two nations have a common welfare. None of these changes has been easy, and they remain a source of controversy inside Mexico since opposing the U.S. and closer ties with the U.S. has long been a trait of Mexican politics and a source of legitimacy for part of the old

Left and many in the PRI. In fact, the 2006 Mexican presidential election essentially concerned whether Mexico should remain within NAFTA and close to the U.S., or whether it should join South American nations on a different path. The question is what Mexico needs to do to alter this debate and move forcefully into a more benign future.

In the spring of 1986, a factory owned by Mexican appliances producer MABE that had manufactured microwave ovens shut down. The plant had been in business for less than a year. While its products were not excellent, Mexicans were eager to prepare meals more quickly. They had seen these ovens repeatedly in television programs and many had bought them through the thriving smuggling enterprise that existed throughout the country. "If it fits on the bridge," according to the old saying, "it can be imported." Of course, the Berrondo family, the owners of MABE, knew of the existence of the parallel, illegal market, but their financials appeared fool-proof. They foresaw a market large enough for them to thrive, just as the majority of other manufacturing ventures in Mexico had, and as they themselves had done with refrigerators for decades. What they did not foresee was that the Mexican government would liberalize imports in the autumn of 1985.

At 50 percent, import tariffs were high, but very much less expensive than what Mexicans were accustomed to paying either to smugglers or to unproductive domestic manufacturers. Imports began to flood the country late in 1985. Some items immediately became available on the market, and microwave ovens, the fad at the time, were everywhere on display. The Berrondos had no choice but to close their plant altogether. But even with their losses, they were fortunate, because they were forced to rethink their business, confront the new reality, and develop a new strategy. They struggled at first, but eventually became leaders of a new market; (they partnered with General Electric and became the largest producers of small refrigerators in the world).

Other manufacturers were less fortunate. While the Berrondos were hit hard, others never saw the hit coming. When my parents built a house in 1961, they bought fashionable "spots," built into the ceilings, for lighting. Both the spots and the sockets were cheap imitations of U.S. products, and after months of use and heat, the bulbs stuck to the aluminum. Over time, I was given the job of breaking the bulbs and replacing them when they burned out. It did not take long for me to develop a strategy: I used an old

hat to catch the glass while I hit the bulb with a hammer. It was a thankless task, but one that had to be done. Three decades later, I bought a new house and, to my disbelief, it was fitted with exactly the same aluminum sockets, and I am again required to perform the same old, thankless task. The manufacturer had learned nothing in more than 30 years. He did not take a direct hit as the MABE microwave oven manufacturers had, but he nonetheless lost his business. The newer housing developments, many of them as large as 5,000 homes in a single site, come with brand-new sockets imported from China that do not stick. Mexico's economy has suffered a revolution, but only a few, usually huge, businesses know about it.

Something similar can be said about the consumers who have been the major beneficiaries of the competition that imports represent. Their welfare has been greatly enhanced by imported Chinese or Korean shoes, automobiles from the U.S., foods, and all sorts of delectable consumer items. But this cannot be said of banking services or of telecommunications, and much less so of water or of power. Despite these contradictions (to which Mexicans are accustomed), these changes have been so important that a middle class has been growing fast. Two things lie at the core of the rapid growth of the middle class: financial stability (which has delivered low interest rates and, thus, access to consumer credit and mortgages) and competitive prices for consumer goods (many of which are imported or where imports bring about competition to the market). Mexico's middle class is not as wealthy as America's, but its existence constitutes a radical departure from a country that traditionally has been poor. The causes of poverty are many and varied, some of them historical, but much of Mexico's economic woes have had to do with protected producers (which negatively affect consumers), subsidies to businesses (which have the effect of raising prices) and a bias of economic policy in favor of producers and the bureaucracy. The policy of economic liberalization of the past few decades has helped diminish poverty and strengthen the ranks of the middle class.

The house where I lived had, as do the majority of houses in Mexico, a cistern on the ground floor and a water tank on the roof. The system operated with a pump that worked whenever the level of water was low above and high below. It was a simple mechanism, but one of very poor quality. I had to replace it approximately every six months, because it would become

rotted from the humidity inside the tanks. One day I decided that enough was enough and, during a trip to Texas, went to Home Depot. I was a man on a mission. I wanted to buy a first-rate device to replace the one I had at home. Nobody understood why I needed what I was describing. I went to another chain, Builder's Square, only to encounter the same lack of comprehension. But a comment the salesperson made at the second store set me to thinking. Such systems are used in very tall buildings only, she said, and they must be specially ordered. That evening I went to dinner at a friend's home. As I entered the house, I suddenly understood; while my home in Mexico had a half-inch water entry pipe, my friend's entry pipe was two inches in width. The flow of water was continuous and did not require water tanks, pumps, or other systems. Mexican consumers can only wish for such a service.

Modern, dynamic companies thrive and improve the life of the population through exports and the creation of jobs. They have arisen in Mexico in large measure thanks to their ability to exploit NAFTA or, simply, to adjust to the demands of a global economy. But they are found next to neighboring old shops and businesses that are unprofitable, that are isolated from the global market, and that survive mainly because of a network of regulations and other means of protection, as well as an informal economy that is all too visible. Far from being a simple issue of tax evasion, the informal economy in Mexico is a way of life, a vehicle to avoid pervasive government interference. However, the consequences of its existence impact the economy at large and inhibit higher growth rates. The net result is extremely low levels of productivity, which render it impossible for the economy as a whole to grow at the speed necessary to create wealth and the jobs that a young population demands.

The case of MABE I cited earlier is not unique. Many Mexican companies have learned to compete, have upgraded their production processes, and have become mighty competitors. Some have become world-class leaders. Bimbo, the bread and pastry manufacturer, now owns similar ventures in South America, Spain, and in the U.S. The same is true for Cemex, the world's third largest cement company, and for Femsa, the fourth largest beverage group in the world. Each has a story to tell, but all share a similar understanding that the future must be built one day at a time, each day at a

higher level of productivity than the previous one. These are big companies by Mexican standards, but not big in terms of the rest of the world. This duality is a permanent source of friction, for many of these companies are blamed for the country's ills. Always the victims, Mexicans have little regard for success and endless explanations for failure.

Much change has taken place over the past two decades, to the point that many features of the old Mexico—manipulated elections, presidential control over the judiciary and legislative branches—are nowhere to be seen. And, yet, other aspects of the old Mexico are very much alive. Reforms have come and gone, but the majority of the political structures of the old Mexico remain in place.

### **THE MISSING LINK: POLITICS AND GOVERNANCE**

Mexico became a democracy and a market economy without dismantling the authoritarian structures, particularly in the corporations, unions, and political parties that convey so much economic power to special interests, often outside the law, such as the schoolteachers' union, the 32 state governors, the two television networks.

When he was Undersecretary of the U.S. Treasury, Larry Summers observed that countries like Mexico had imported the hardware of democracy and the free markets, but had not bought the software that is needed to make them work. He was correct. Elections are only seldom disputed, and when they are, it is the Electoral Tribunal that has the final say. It was not always so. Only a few years ago, it was the post-electoral period that mattered, for it was then that the election was really decided: in demonstrations, in street fights, and in the media. Today, the voters decide who will govern and who will represent them. Unfortunately, this is all they are allowed to do. Once they are voted in, politicians feel neither obliged to cater to the voters nor do they care what happens to their constituents. Mexico's democracy is thwarted and offers few benefits to voters, with one major exception. While the system is far from perfect, it does limit the most egregious forms of abuse, such as President José López-Portillo's personal decision to expropriate the private banks in 1982.

In politics, the old and new Mexico also clash. Mexico has advanced toward democracy and the rule of the law. The new Mexico boasts a modern Supreme Court whose decisions are respected by all. Mexico's new electoral authority demonstrates that it is possible to move away from a totally rigged electoral system toward a true democracy in which votes count and results are respected. But the old Mexico remains, in the form of unaccountable governors, a propensity to ostracize citizens who do not conform to the powers that be, and political parties and television networks devoted to extortion. The country's transition into democracy has been the result of a thorough overhaul of the electoral system, but one that did not capsize many of the PRI-era authoritarian structures. Major interests and interest groups—both those that developed within the PRI as well as those that existed on the fringes of the political system—whose power was formerly held in check by the overarching presidencies of the old PRI regime, are now independent and pursue their interests without checks or balances. Known as “de facto” powers, they thrive on thinly disguised extortion: some employ blockades or massive demonstrations to flex their muscles, while others utilize their media outlets to tarnish reputations and defame competitors, government officials, and anyone who represents a threat.

The old and new meld together in unsuspecting ways. One day, then President Carlos Salinas de Gortari, the “great modernizer,” realized that the PRI, the party that by then had governed Mexico for six decades, could no longer be funded directly from the National Treasury. A modern leader, Salinas understood that the old ways were simply not acceptable in the era of NAFTA and with the eyes of the world media directed toward the country. But how, then, to fund the PRI? The National Action Party (PAN, its acronym in Spanish) had perennially resorted to lotteries and raffles for funding, while other parties sought donations of various kinds. Salinas showed the duality of the country's politics, and of his own personal values, in the way he finally resolved the issue; he found nothing incorrect, politically or otherwise, with inviting some 30 big entrepreneurs to dinner and requested from each \$25 million for the party's coffers. The old and the new are ever-present in Mexico.

The defeat of the PRI in the 2000 presidential election changed Mexico forever, but was not associated with an institutional transformation that

would produce a balanced political system. The old presidency was all-powerful largely due to its marriage with the party, an entity much more a system of political control rather than a U.S.-type election-oriented organization. The PRI ruled over a vast network of organizations that reached the most remote areas of the country and that served to impose and enforce presidential decisions. Once that marriage dissolved, the “new” presidency proved to be weak and incapable of dealing with the realignment of political power that the election produced. This is best illustrated by the persistent failure to enact reforms, address major issues (such as the decline of oil production), or agree upon a way to overhaul the political system.

One of the unexpected, and negative, byproducts of the 2000 election was that Mexico’s many imbalances became fixed in place. Major special interest unions, huge business enterprises, and the drug cartels, among other entities, became paramount and largely ungovernable; the absence of institutional rules to guide relationships among the presidency, the legislature, and the judiciary meant that governing suddenly became nearly impossible, and other forces, particularly the drug lords, suddenly acquired a previously unfathomable degree of freedom. The old presidency dealt with, and sometimes reigned over, many of these interests and interest groups in non-institutional ways; the new presidency possessed no such instruments. This vacuum opened endless opportunities for crime, violence, and instability, and exposed the weaknesses of the many police forces throughout the nation. These imbalances exert an increasing impact on the U.S., both because of the spillover effect (such as kidnappings or killings of Mexicans in the U.S.), and because they invite radical political options that offer a return to the past. In the Mexican mindset, the past is never too far away. Some of this way of thinking, as Octavio Paz has long argued, has to do with culture, but a lot has to do with the magnet that the old, authoritarian, political system retains. Things look simpler from afar.

In a novel of the 1960s, *The Mongol Complot*, police investigator Filiberto García solves a crime by pulling and pushing, forcing confessions, and threatening people. He was absolutely efficient, but he would not have passed muster in the modern rules of behavior and the protection of citizens’ rights. Captain García was a sign of the times. The police force was not modern by any standard, but it was effective. The entire political system was organized

from the top down, and each level exerted control over the lower rungs. The police force was part of the system and, as such, shared in the benefits. To the extent that the public order was maintained and crime levels were low, the police could act as they pleased. This certainly was not an ideal world, but it worked, not because the police were well trained, but because there were balances in the system that hindered them from joining the criminals.

The story of this police inspector epitomizes the whole thrust of change that has overtaken the country over the past few decades. On the one hand, the concept of the rule of law was totally absent—non-existent in fact. On the other, the balances that did exist were administrative ones, meaning that they served the purpose of control from the top down. They were not meant to be institutional checks on power. In this context it is impossible to plan and thus, the government never plans; the rule of rule, as opposed to the rule of law, creates a world of relative uncertainty that pervades everything, including the reform process.

## CHANGING THE HARD WAY

Mexico's process of transformation from a protected economy and an authoritarian regime did not emanate from visionary and learned leadership. Rather, the PRI-led governments produced endless economic crises and ever-growing political conflict. Change took place because there was no alternative. But it took place in a disorderly fashion, the result of pushing and shoving. Hence, the majority of the old structures remain in place, while the relative political power of each of the actors—particularly the three branches of government and the state governors, but also the non-institutional powers previously mentioned—have changed radically. The effects can be observed in the need to deploy the Mexican Army as a police force, for which it was never trained, in the absence of a truly professional federal or local police force and, more importantly, in the absolute inability to develop such forces in an institutional manner. Each of these failures has translated into points of conflict with the U.S.

This disequilibrium, particularly in the area of law enforcement, has provided a boon for all sorts of illicit trade and is one of the most important sources



of violence and conflict in Mexico. Of particular importance is the sudden collapse of the federal government's ability to impose order in a country notoriously characterized by the absence of a modern political force or an effective judiciary. The old political system was top-down, and everything was under the control of the president, who used the governors as instruments of his rule. The collapse of the old presidency left the governors on their own, but with no incentive to modernize local institutions, including the many local and state police forces. The paradox is that Mexicans experienced two dramatic changes that were largely contradictory: on the one hand, freedom of expression exploded with the end of the authoritarian structures; on the other, as the governors (and other politicians) became ever more powerful, they began to reassert control at the local level and, in many a case, became deeply involved in all sorts of illicit activities. Although there is no clear proof, many governors and local authorities likely are deeply involved in the drug trade.

Changes in the illegal U.S. drug market—particularly the relative decline of cocaine and ascent of methamphetamines—were coupled with the disappearance of a functioning government in Mexico, creating opportunities for the drug mafias to extend their tentacles, control territories, and challenge the government. The outgoing Felipe Calderón-Hinojosa presidential administration understood the nature of the challenge and launched an all-out attack on the drug mafias in an attempt to stave off the challenge to the nation's security.

The combination of a dysfunctional system of government, an economy that is incapable of providing the jobs and sources of wealth that are required, and the challenge that the drug mafias represent constitutes a grave threat to the country's stability and, thus, to the U.S. Whether one likes it or not, because of the long, shared border and the migration of goods, people, and violence, what takes place in and around Mexico will affect the U.S. to a vastly greater extent than does any other place in the world.

Migration is as much an attempt for Mexicans to improve their livelihood as it is a response to an ever greater integrated North American labor market. Counter to deeply held beliefs, the majority of migrants tend to be employed and they are sufficiently entrepreneurial to take on the risks and costs inherent to crossing a border and searching for a job in an alien place. It is the combination of lack of opportunities for improvement within

Mexico, as well as the attractiveness of the U.S. economy, that have joined the two nations at the hip.

Lack of opportunity in Mexico stems from many a source. First, there are many invisible “glass ceilings,” not only for women but for all Mexicans, the result of a tightly knit political system that preserves the status quo. Second, the educational system, dominated by the teachers’ union, is aimed at maintaining control of the population rather than providing skills and opportunities for them. Finally, although imports were liberalized in the mid 1980s, much of the domestic economy remains besieged by regulations, non-tariff barriers, and other mechanisms that privilege the informal economy while rendering it very difficult for new, legitimate businesses to grow and develop.

José Hernández-Moreno, a Mexican and the newest Hispanic astronaut, exemplifies what thousands of Mexicans aspire to be and the legitimate success about which they dream. Perhaps his story sums up the country’s problem: his achievements cannot be repeated by the majority of the remainder of Mexicans. There is something, or many things, that do not permit the country to grow at a fast pace. How tragic that for a poor Mexican (or for his descendants) to be successful, he was forced to migrate to the U.S. Such is the case of Hernández-Moreno, who became an astronaut because he lives in the U.S.; Antonio Villarraigosa, the mayor of Los Angeles, one of the largest U.S. cities; or Mario Molina, who won a Nobel Prize because he was a researcher based in the U.S. Living in the U.S. gives Mexican migrants access to a world of possibilities that are not within the reach of those who stay in Mexico.

Whether Mexico succeeds or fails over the next several years, the impact will be faced, if not borne, by the U.S. In this regard, what happens in and to Mexico matters to the U.S. A successful Mexico would add competitiveness to the North American region and would aid both nations in creating sources of wealth and jobs that neither can develop on its own. The opposite is equally true. Mexico’s ills manifest themselves in several ways, but primarily in an unrelenting spillover of the violence associated with the drug cartels, in the lack of growing demand for U.S. goods and services, and in the persistent streams of migrants moving north. North America is a single region; unless both nations work together to address their ailments, both will suffer.

There is nothing more difficult to take in hand, more perilous to conduct, or more uncertain in its success, than to take the lead in the introduction of a new order of things, because the innovator has for enemies all those who have done well under the old conditions, and lukewarm defenders in those who may do well under the new. This coolness arises partly from fear of the opponents, who have the laws on their side, and partly from the incredulity of men, who do not readily believe in new things until they have had a long experience of them.

—MACHIAVELLI, *THE PRINCE*, 1513, CHAPTER VI

### III. A Different Mexico

According to an old adage, the Stone Age did not end for lack of stones. Many of Mexico's problems today—an extremely violent battle against organized crime, lackluster economic growth, and endemic corruption—might appear overwhelming, judging from the news headlines. But contrary to what many might believe, these problems are not intractable. For one, they are a very different set of problems from those that Mexico used to face. Indeed, many of the problems are the result of the (often unfinished) changes that Mexico has undertaken over the past few decades, some of them unplanned, others the result of conscious reforms. All of these, whether adequate or not, are setting the foundations for a potentially better future. The Stone Age eventually ended because humans found better ways to survive other than depending on stones alone. The same is true of Mexico.

Mexico today is a nation constructing its future while struggling with its past. The 1992 North American Free Trade Agreement (NAFTA) began a profound process of economic transformation. Similarly, the 2000 electoral defeat of the ruling Institutional Revolutionary Party, the first alternation of Mexican presidential power in over 70 years, began a profound political transformation. However, neither of these transitions has yet delivered the expected results. The conflict that characterized the aftermath of the recent presidential election is a good example of this.

Structural reforms in the 1990s liberalized Mexico's economy. They expanded opportunities for private investors, but did not help the economy reach and then sustain high rates of growth. Meanwhile, the political system remains far from perfect. Even so, there is frequent alternation of parties at all levels of government, greater transparency and even a modicum of accountability. At the same time, a number of world-class industries have developed in Mexico. A new middle class also has emerged. These are considerable accomplishments in a country where over 40 percent of the population lives below the poverty line.

Nonetheless, Mexico's troubles today largely stem from the shortcomings of the reform process itself. The changes they unleashed were almost cataclysmic. They forced an inward-looking economy to face world competition. They also loosened the stranglehold that one political party, the PRI, had long held over the nation. Unfortunately, neither of these changes was properly thought through; nor was there a common political consensus about what should happen after they took place.

The result has been twofold. In the political sphere, the decentralization of power has not been accompanied by the development of stronger state and local institutions—a *sine qua non* for the maintenance of public peace and accountability. Further complicating the process, criminal organizations simultaneously began to expand their businesses and move into new territories. Weak law enforcement institutions, including the police and the judiciary, have subsequently proved a very poor match against these emboldened criminal mafias.

A similarly incomplete reform process took place in the economy. In the 1990s, the privatization of local banks and public monopolies was more concerned with raising government revenue than changing market structures. As a result, private monopolies still dominate some sectors of the domestic economy. Meanwhile banks, having survived near-bankruptcy following the 1995 peso crisis, are now strong enough to lend and finance growth again—yet they are hardly doing so. The main sources of the country's current troubles do not lie abroad, as some Mexicans might claim. They are home grown.

Some Mexican and foreign observers despair that the country's problems are so huge, it is impossible for the country to progress. This is, indeed, a reasonable conclusion. Politicians never seem to agree on anything. There appears to be no end to crime, both big and small. The economy is growing, but creating few new jobs. The country has just gone through an election that brought the PRI back to the presidency, opening new avenues of both opportunity as well as scorn. The future certainly looks complex. Yet, if one steps back, it is amazing how much has changed, and much of it for the better.

There have been two economically successful eras in Mexico's history: one at the end of the 19th century, the other during the good years of PRI

rule, particularly in the 1940s–1960s. The common trait of both eras was strong central government. The lesson for the future is that Mexico can function either with a strong central government or strong institutions. But it cannot function without both.

Mexico's experience with democracy over the last two decades shows the pitfalls of decentralization without strong institutions. Over the past two decades, power and budgets have been devolved to the states. Rather than an effective federal system, however, this created regional baronetcies instead. Mexico, according to one sarcastic assessment, is the only nation in the world to have gone from monarchy to feudalism.

Mexico's experience of decentralization, however, is more than just fodder for clever commentary. It is the main task that Mexico faces. The challenge is to consolidate, amid great political complexity, an extraordinary recent accomplishment: the fact that most Mexicans are now middle-class. How to do that is the central question the country faces.

Mexico is not ungovernable, as some might believe. It has simply not been governed of late, which is a very different proposition. That is why better government and smarter leadership, combined with strategic vision, could change the country very swiftly. As with the end of the Stone Age, the Mexican government just has to get its act together.

## THE ERA OF REFORM

Despite its shortcomings, the transformation of Mexico over the past three-odd decades has been profound. Yet, it has failed to attain the objectives that were expected. High rates of economic growth failed to materialize and the political system is yet to become truly democratic, representative or functional. These problems stem largely from the way the reforms were carried out—and the criteria that drove them.

Beyond specific reforms, in retrospect it appears evident that there was no reform strategy, nor an integral vision of what was being attempted to accomplish. Needless to argue, there was no consensus-building effort behind the reform process, largely because the PRI saw it as a way to remain in power: building a consensus would have implied a willingness to share

power and, eventually, enter into a political transition. In one word, the reforms were a last-ditch attempt to maintain the PRI in power.

The consequences of such a reform process are, hence, there for all to see. Some economic sectors were liberalized, others were not; some government concerns were privatized (mostly turning a state-owned monopoly into a private one), others were not. The importation of most goods, but not services, was liberalized.. Each one of these factors became a source of eventual conflict. While most industrial goods were subjected to import competition, the Mexican manufacturers experienced the crunch of much higher domestic costs of credit, communications, power, and the like, than their competitors around the world. Hence, productive chains were broken and Mexican producers found themselves incapable of competing.

If the economic reforms were plagued by inconsistencies, the political arena experienced a much worse situation. While there was an explicit aim to reform the economy, there was no such purpose in the political arena. The implicit objective of the economic reforms was precisely the opposite: to avert the need of any political reform. Hence, there were as few, and as minor, reforms as possible. In contrast with the proactive nature of the reform process in the economy, there was only reaction in politics. The mismatches and contradictions of reform in the economic arena were the result of political obstacles that were known by all; the contradictions in the political arena were the expression of a political system, a clique, unwilling to change or, more to the point, to share power.

In this context, the outcomes of these circumstances were thus fore-ordained. Despite the profound changes that both the economic as well as the political arenas have experienced, many of them truly transformational, few of the original objectives—particularly a high rate of economic growth and a democratic system of governance—have been met. The economy continues to experience the inherent contradictions of explicit decisions made during the reform process, while the political arena is in permanent upheaval. In the absence of a reform plan, a democratic transition took place in 2000, for which none of the political actors was prepared. No rules had been agreed upon and a political novice ended up in the presidency.

Power ended up being decentralized without first having been institutionalized. Thus, organized crime found an open gate for which there was no match in the country's judiciary or in the police forces at any level of government. Political power was fragmented and dispersed, creating broad opportunities for all sorts of special interests to achieve veto ability in their sector, region or area of interest. A similar situation occurred in the fiscal arena. As power dispersed, so did public expenditures; state governors ended up with not only broad authority to advance their own interests and objectives, but also with huge spending influence for which they were largely unaccountable. The so-called "de facto powers," most of them spin-offs from the old PRI networks, were thus born. Unions, political clusters, companies and some individuals in these areas acquired extraordinary influence, thus thwarting further reforms and the possibility of attaining the desired objectives. The distortions that characterize the Mexican economy did not happen by chance.

In the economy, two contrasting worlds survive: that of the hyper successful and competitive sectors that export, compete with imports, and whose development ranks among the best in the world, and a creaky old economy that barely clings to life. The former generate wealth, the latter live on the leftover morsels. To a great degree, the existence of these two worlds explains our economic reality: when exports grow, as they have the last two years, the remainder of the economy begins to function; when exports decline, as happened in 2009, internal demand collapses. In Japan, for example, it is estimated that 20 percent of firms provides buoyancy for the remaining 80 percent. But that 20 percent produces much more, at a lower price, and of better quality than all of the rest.

The similarities with Japan do not stop there. The reason for two worlds in counterpoint has to do with the protection, explicit or implicit, de facto or de jure, that characterizes the internal market. Some of the protection mechanisms are obvious: there are customs duties and levies, norms, or subsidies that do not permit determined products to be imported or that render the cost of their importation prohibitive. The beneficiaries of these mechanisms are delighted, but what is interesting is that there is no recognition, not even among the entrepreneurs themselves, that protection for some implies lack of protection for others. If a footwear



entrepreneur enjoys protection in the manufacturing of shoe soles, his products will be more expensive than the alternative, thus shutting the rest of the shoemakers out of the market. The protection that so many business people covet has the effect of reducing the competitiveness of the entire economy. Businesses and sectors that are successful have no protection; that is why they're successful.

In the 1980s, MIT published a study titled "Made in America," which analyzed several American economic sectors and how they had fared vis-à-vis the Japanese competition. At the institution where I work, CIDAC, we pursued the same idea with *Made in Mexico*, a book that explained many of the difficulties the Mexican economy was facing and produced many relevant and tough lessons.

The main lesson was that economic liberalization had had quite a differentiated impact on Mexican industrial companies. Those devoted to easy-to-import goods had an immediate, often devastating effect. Typical of these were appliances and electronics (refrigerators, televisions, and microwave ovens), which were showcased next to domestic products that were of lesser quality and older technology. Businesses in those areas had to react immediately or capitulate. The prototypical case study of success was MABE a company that, as was mentioned in a previous chapter, not only understood the challenge, but found the most creative ways to transform itself. Many more disappeared from the marketplace.

Very different was the case for goods and sectors where the alternatives for the consumer are less direct. In these cases, only those producers that were true entrepreneurs were able to comprehend the depth of the challenge and its implications. There are notable examples of small companies that swiftly globalized, but thousands more that might have adjusted could not understand the nature of the change taking place beneath their feet. A classic case of the latter is that of the manufacturer of carburetor springs who continued to produce what it had done and so well for so long that the market simply vanished. The owner was an exceptional engineer who understood the technical side of his wares and could compete with the best in his field, but failed to grasp the fact that technological change had done away with carburetors—in other words, he was a fine engineer, but no entrepreneur.

These examples illustrate the persistent challenge of the Mexican economy. It is not that there is a shortage of capacity, but that it has not been channeled. Thousands of businesses that grew in a protected world of imports and bureaucratic controls and whose profitability had more to do with closeness to the bureaucrats than with the quality or price of their products, did not develop an instinct for competition or the ability to adapt to changing market circumstances. They continued to produce what their predecessors had done from one generation to the next, often even with the same machinery. Hence, it would not be surprising to find huge contrasts in performance across various parts of the economy. These then become easy to fathom. But the relevant fact is that Mexico has two economies, and the successful one produces 80 percent but only employs 20 percent. There will be no progress if the internal economy is not resolutely worked out. Conceptually, this is not very different from what happened in Japan.

Of course, the great difference between Japan and Mexico is that the Japanese have an extraordinary quality of life. The country's population does not grow, and it has all of the satisfiers to which its inhabitants can aspire. In contrast, Mexico has a young population, a high unemployment rate, and an economy that frequently produces goods that are inferior to the available imports. What is amazing about the Mexican economy is that there is no lack of individuals with outstanding entrepreneurial spirit: the informal economy is overwhelming proof that the Mexican is exceedingly "Johnny-on-the-spot," available, creative, and "a mover and a shaker". Sadly, the informal economy cannot resolve the country's development problems despite the fact that it employs two-thirds of the economically active population.

Some months ago, Gordon Hanson published a study on why Mexico is not a rich country. His point of departure is that the country has carried out many reforms and that, in general, these are much more extensive than those of the majority of countries at a similar level of development but, unlike these, it has not achieved a rise in its growth rate. His analysis is also interesting because it excludes many of the clichés and myths that persist in the milieu. Corruption? Yes, but many countries that do grow are equally corrupt. Hispanic heritage? Yes, but, with the exception of Venezuela,

Mexico is the country with the least growth in the region. Government-owned firms? Yes, but there are many such firms in Asia and Latin America and these enterprises do not have to be an impediment. Cultural rejection? Perhaps, but that element is not so distinct from that of the remainder of the continent that grows with celerity.

Hanson's conclusion is interesting because it does not pretend to attain the philosophers' stone. From his point of view, there are five factors that interact negatively to impede the growth of productivity, but it is very difficult to know the relative importance of each, which is why there is the risk of overestimating a specific cause only to later find that the problem lay elsewhere. The factors are the following: extremely poor allocation of credit; high incentives for the informal sector; a poor educational system; control of some key markets; and vulnerability to external shocks. However, the core of his conclusion is that there is no governmental capacity; that is, that the government is barely effective, that it generates too many distortions, and that it does not contribute to resolving the problems of the economy despite having attempted to do so with such diligence.

Mexico has endeavored for decades to set economic growth aright. Along the way, solutions were tested that plainly did not achieve this goal, but instead, created a deep-seated wake of uncertainty. The only clear lesson to me is that a strong government is required with a great capacity of action to render market functioning possible. Today we know that we have a weak system of government that has done its best to attempt to regulate, if not substitute for, the functioning of markets. Perhaps the time is right to make it possible for these to work.

The recent elections brought the PRI back to the government. Some have feared a regression to an authoritarian past. Voters proved much smarter than that, delivering a divided government. Enrique Peña-Nieto, the new president, will have to negotiate his way to get things done. Could he do better than his predecessors? There are two reasons to be optimistic: first, he is a natural politician and, as governor, has had vast experience as a political operator. He is a hands-on man who will not shy away from building agreements with any of the opposition parties. The second reason is that Peña will be joined by savvy and

experienced legislators who will have the same objective of getting key reforms passed through Congress. From this vantage point, Mexicans will get an effective politician as president and the need to get things done quickly, as well as the incentive to look toward the future. Voters are likely to be vindicated.

When people realize that things are going wrong, there are two questions they can ask: One is “What did we do wrong?” and the other is “Who did this to us?” The latter leads to conspiracy theories and paranoia. The first question leads to another line of thinking: “How do we put it right?”

—BERNARD LEWIS: *THE WEST AND THE MIDDLE EAST*, *FOREIGN AFFAIRS*, JAN-FEB 1997, P 121

David Landes adds, “In the second half of the twentieth century, Latin America chose conspiracy theories and paranoia. In the second half of the nineteenth century, Japan asked itself, ‘How do we put it right?’ David Landes: *Culture Makes Almost All the Difference*”

—*CULTURE MATTERS* (LAWRENCE HARRISON ED) P 7 QUOTED FROM LAWRENCE HARRISON, *THE CENTRAL LIBERAL TRUTH*, P 6, OXFORD, 2006

## IV. The Conundrum of Mexican Politics

Mexicans agree that there is a need for better organization to successfully confront the challenges they face, since current political institutions and arrangements are not working. There is no consensus, however, on how to do this. As a result, although political reform has become an inexorable necessity, it is not obvious that such reform will be possible. Now that the PRI is back in power, the question is whether a new governing arrangement is possible.

Mexico's "modern" political system was developed after the Revolution of 1910. Years of civil strife, instability and more than one million deaths eventually led to an agreement among the various cliques of revolutionary leaders, which was worked out in greater detail in the Constitution of 1917. It would take another decade before this agreement translated into a viable structure of governance, but the groundwork had been laid. The Revolution was over and the country was ready for peace, stability and economic development.

In lieu of a concrete and workable governing structure, however, the revolutionary victors ended up creating a political system by proxy. Though formally considered a political party, the Institutional Revolutionary Party (PRI), was more a system of political control than a traditional party. The PRI operated at various levels: it settled disputes among the several political groupings and factions within the party, controlling the masses through a structure of unions and organizations that channeled disputes while establishing limits to political participation, centralizing power, and enforcing its rules and decisions concerning the society at large. The PRI proved to be a lasting organization because it responded to the complexity of post-revolutionary Mexico.

When the PRI finally lost the presidency in 2000, the old political system was altered. The association of the presidency and the PRI had conveyed the impression that the president was all powerful. Once the two entities were "divorced," however, the true powers of the presidency proved

to be much more limited than they had appeared. The president, through the party, had been able to control sizeable swaths of the population and enforce his decisions. Governing was possible largely because of the combination of the presidency and the party. Once the party ceased to be an instrument of the presidency, the ability of the president to implement his plans on his own disappeared.

The PRI defeat in 2000 thus became a line of demarcation, the end of an era and the beginning of a new reality. The moment was singularly poignant for members of the PRI, whose system had operated on the basis of implicit reciprocity of loyalty in exchange for access to power and corruption. The majority of the party's leading members were fearful of being thrown into jail, prosecuted or accused of wrongdoings. Many observers considered this moment to be an ideal opportunity for negotiating a new foundational agreement among all of the political parties and organizations. Unfortunately, Vicente Fox, the incoming president who belonged to the Partido Acción Nacional (PAN), did not see it this way. For him, the morality of the PRI politicians was a greater problem than the need to create new governmental institutions (and yet did not punish the former or develop the latter).

In retrospect, the basis of political power changed with the defeat of the PRI, but the institutions charged with wielding power remained the same. It soon became evident that the new reality was dysfunctional. First, much of the power formerly concentrated in the presidency flowed to the state governors, political party leaders and the entire gamut of special interests—unions, business groups and politicians—that became relevant actors in their own right. Mexicans call these groups the “de facto powers,” signifying powerful groups outside the boundaries of any institutional check and often completely outside the law.

Over the past ten years, some arrangements have been made to accommodate the new reality of power, but making and implementing decisions remains a true challenge. The governors now control federal purse strings and have reproduced many of the features that formerly characterized the old presidency. At least one important explanation for the country's slow economic growth lies precisely with this decentralization of power from the president to the governors. Whereas in the past the majority of spending programs were

viewed as instruments of development, and competent bureaucrats and economists attempted to maximize the economic impact of these projects, the majority of current spending plans are created and run by governors having a more limited scope and a much more short-term perspective.

Several attempts have been made over the past ten years to introduce political and social reforms. Some have prospered, but the majority were altered to such an extent that no reform took place. For a long time, high oil prices made it possible for Mexican politicians to ignore the need for reform, but even they were unable to avoid the obvious fact that other nations—Brazil, China, South Africa, Chile and India—were growing much faster than Mexico. Reforms on social issues and political rights have prospered, for they affect few powerful interests. Economic and political reforms that touch special interests are another story. Thus, the question remains: Can reform now—under a PRI government, be implemented? If not, what would it take to bring about needed reforms?

The election of Enrique Peña-Nieto brings PRI back to the presidency, albeit without a legislative majority. Many feared that having the PRI back in the presidency and with control of both houses of Congress would lead to a recreation of the old authoritarian system, much as Russians have experienced with Putin. The voters, however, delivered a different result: Peña will have to build a coalition in order to govern effectively. The big question now is whether Mexicans in general are incapable of building coalitions or if it was the political inexperience of recent presidents that made that impossible. A lot rides on the answer to this question. Peña's experience as governor and his performance during the campaign suggest he will be very deft and quick. Having said that, Mexican governors are not known for their coalition-building skills or devotion. In the absence of accountability at the state level, governors have enormous leeway to control the media and cajole, or buy, their opposition. What makes a PRI president potentially different is not his or her personal qualities but the fact that their breeding ground is that of politics: they grow and develop in a medium where leading, negotiating and getting things done is a natural habitat, very different from a PAN environment.



## THE CURSE OF REFORM

The majority of political parties and politicians recognize the need for reform of the Mexican political system, but there is no agreement on the nature of the required reforms. In fact, there are ever-increasing proposals aimed at finding a solution to Mexico's political problems. Over the past few years, several reform proposals have been tabled by various legislators and the executive. Although each set of proposals had different emphases, they all were a response to the difficulties and complexities that Mexico confronts in its decision-making processes.

The fiscal/economic area provides one example. Although a discussion regarding the need for an "integral" fiscal reform (whatever that means) had been on the back burner for decades, no move has taken place, even at times of lower oil prices (a key component of government revenue). At the same time, the question of how the money should be spent has returned to the agenda. As the relative power of the Mexican state governors has grown—they currently control the majority of public expenditures and one has recently won the presidency—economic distortions have increased. The politics behind these expenditures are important: early in the Fox administration, the governors organized themselves into a virtual syndicate to demand greater control of the public coffers. They achieved this goal by making it clear that the former power of the presidency had fragmented and that the new reality of power would be reflected in the distribution of public funds.

In short, the post-revolutionary pact of the PRI era resolved issues of the distribution of power and money throughout the seven decades of its rule. This age ended with the 2000 decision of the voters at the polls, but the institutions charged with the administration of power relationships and the distribution of money did not reform. This problem, and nothing else, is what lies behind current proposals for reform, both institutional and financial.

The clamor today is not due to electoral, institutional or fiscal reforms, but rather to an integral power reform. Interestingly, and oddly enough, this outcry does not essentially derive from society, but instead, from the political groupings and parties themselves. It is these who lust after the development of mechanisms to wield power, control their opponents, and have an opportunity to access power through means other than those available at present.

Indeed, the majority of reform proposals are not at all altruistic: most reflect the needs and interests of very specific groups or individuals who want to make their chances of winning even better or, at the very least, to lower the prospects of their competitors' doing so. In other words, all these groups want to create a new version of the concentration of power that characterized the old PRI system, but under their own control. In other words, politics as usual. However profound and intelligent the proposals that dominate the public debate are these days, the key problem—the question of power as opposed to that of procedure—is not being dealt with at its root.

Context is important here. After the financial collapse of 1982, the so-called Mexican “debt bomb,” Mexico’s government initiated a long and painful process of economic reform aimed at creating a solid foundation for high and sustainable rates of economic growth. The intent of the reforms was to liberalize the economy, increase competition (largely through the liberalization of imports of foreign goods), privatize government enterprises (such as telecoms and television), and, in general, deregulate the economy. Although many of these reforms were extraordinarily successful, one important implicit objective was to maintain the political status quo; that is, not to threaten the power of the PRI.

History attests to the failure of this objective. Some of these reforms, such as the privatizations, further concentrated political and economic power, and the special interests succeeded in becoming protected. Some privatizations, such as that of the banks, were so costly that the majority of Mexicans now associate reform and privatization with crisis, privilege and risk. As a result of this legacy, politicians have concluded that reform of any kind risks provoking the voters’ wrath. To top it off, largely as a result of those reforms, the PRI split and its left eventually moved on to form the PRD (Party of the Democratic Revolution). It was then, the mid 1980s, when the old PRI system began to lose its ability to impose its decisions.

## **REFORMING POWER**

Everyone in Mexico is aware of the dysfunctional relations that exist between the congressional and the executive branches of power. No less

important, however, are the distortions in the power relations between the federal government and the states. The reality of power has made state governors unaccountable to their citizens, to Congress and the presidency. Public expenditures pour forth, but accountability is absent. At the same time, the capacity of the former political system to make agreements and to implement them, which made the country governable, has disappeared.

Part of the problem is that the PRI tends to blame everything on the alleged incompetence of the PAN. While there may be some truth to the charge, the underlying problem is structural. The absence of structural reform means that although the legislative docket is very full (many bills do become laws), most bills submitted by the executive to the legislature are frozen or modified to such a degree that they become bland or irrelevant with respect to their initial objectives.

Compounding the problem is the fact that Mexican citizens, who for the first time have a voice, albeit a limited one, distrust their government. Recent, relatively mild tax increases were rejected outright, not because they were good or bad, but precisely because most Mexicans do not trust the government. In a recent poll, the majority of Mexicans rejected a proposal to introduce congressional reelection by a margin of 8 to 1. The re-election question was posed in the poll as a way to reward good legislators. When the question was reversed, however (i.e., that re-election would permit punishing bad legislators), the numbers shifted. Mexicans are upset with their leaders but, other than the vote, have no means to influence their behavior or remove them from office. Hence, opinions on any issue, such as a tax increase, not only reflect the respondents' reality of high living costs or limited incomes, but also, deep-rooted dissatisfaction with the performance of the economy and the government, as well as citizens' exclusion from the decision-making processes. In a word, Mexicans do not feel represented by the Congress.

In addition, Mexicans have been unable to agree on a basic definition of the current political reality. For example, the members of the PRI believe that Mexico was always a democracy. For PAN members, democracy surfaced only in 2000, which was, coincidentally, when they won the presidency by defeating the PRI. The members of the Party of the Democratic Revolution (PRD) largely believe that democracy will arrive only when they win a presidential election. Thus, according to one party or another,

all elections to date have been corrupt and illegitimate. When a country's key politicians cannot even agree on the nature of the foundation on which they are standing—or even on the era in which they are living—it is impossible to negotiate specific bills. Everything is viewed through a prism that has nothing to do with development, progress or accomplishment, but much to do with the destruction of an enemy. Within this context, a reform of political power becomes both critical and difficult.

All this conflict, controversy and displeasure are evidence of a country whose day-to-day operation requires a new pact to establish, or re-establish, equilibrium among the branches of government, the political parties and between the central government and the states. There are several ways to deal with this problem. One approach that has been attempted involves the presentation of proposals and counterproposals that overload the legislative agenda without offering any possibility of solving the basic problem. A second approach would involve designing a great political pact of the sort that appears only once in every century, one that establishes the foundations of a general transformation of the country. The third approach, which is the most pragmatic, and which has oriented dozens of nations facing similar situations (e.g., Brazil, India, China and South Africa), involves implementing enough limited reforms to create the conditions for achieving a more durable, long-term arrangement—in other words, pursuing a muddling-through strategy for as long as it takes to forge a truly grand transformational bargain. Mexico is probably about to experience a fourth tack under the recently elected PRI now back in the presidency: a functional and working intra-party legislative majority.

In general terms, politicians prefer the first approach, because it provides them with an exceptionally prominent role, whereas academics and political bench-warmers prefer the second, because they can view the whole panorama and prefer a complete solution over a patchwork approach. The third approach is one that governments like, since it is based on the daily functioning of their political system rather than on what they regard as magical solutions that, in politics, rarely exist. The approach likely to be attempted by new President Enrique Peña would be based on both a very visible exercise of political leadership as well as active political maneuvering beneath the surface.

The case of Brazil is enlightening. The Brazilian political system is as dysfunctional as Mexico's (although this is attributable to very distinct reasons and characteristics). Nevertheless, Brazil has achieved pragmatic continuity among administrations of distinct beliefs for 16 years. In contrast with Mexico, the Brazilians did not have the weight of the past, and of such a high-handed political system, with which to contend. In addition, while Mexico's governments, even those of the same party, rarely build on the accomplishments of previous administrations, Brazil's presidents Luiz Inacio Lula da Silva and Fernando Henrique Cardoso appear to have been cut from the same cloth. As a result, Brazil was able to move ahead much faster than Mexico in recent years. Mexico is compelled, therefore, to launch a new wave of reforms in order to create a new momentum.

All the nations that Mexicans consider to be comparable to their country, at least in terms of economic performance, have difficulties and challenges of their own. Despite its astonishing successes, China faces dire, long-term challenges. And India's political, social, religious and ethnic complexities have not impeded it from launching important reforms. What is significant is that these nations have not found a perfect solution to their problems, but they have found ways to organize themselves to make economic growth and development possible. Herein lies Mexico's true challenge.

The majority of current proposals for political and institutional reform in Mexico apply to real problems facing the country. But their thrust concerns procedure: whether to confer additional powers on the president, alter relationships between voters and political parties by introducing re-election, or, in the French tradition, create the office of a prime minister to strengthen the legislature vis-à-vis the executive and move toward a semi-parliamentary system. These and other ideas warrant debate, but they do not address the core issue of power. If implemented, they would modify, in some cases radically, the formal relationships among the political parties and the branches of government. But it is unlikely that they would improve the quality of governance, or of the government itself. For this to occur, Mexicans would need to reach an agreement on the most basic issues: Where do they stand now? What are today's challenges? Is Mexico a democracy? Can the current reality be seen as the basis for the future and then can each party negotiate whatever changes are needed?

Quite probably the various political forces, political parties, and “de facto powers” do not agree on the answers to these very basic questions. As long as they do not, any reform, however important, is not likely to improve the country’s governance or its economic performance. Does this situation warrant lower aims with a longer-term outlook?

Achieving a great foundational pact would be extraordinary, but the recent election has created a new opportunity. The key question today is whether a more competent politician in the presidency could (or would be willing to) articulate the kind of consensus required for laying the foundation of anything useful.

### **THE INSTITUTIONAL CHALLENGE**

When institutions are strong and limit the sphere of action—that is, they restrict the effective power—of whoever currently occupies the presidency, the person of the president becomes important but not crucial. In this manner, independently of the natural differences between parties and candidates, no American, British or Canadian citizen perceives that his or her country will live or die as a result of an election.

The contrary is true in nations with weak institutions, in which the person occupying the presidency exerts a colossal impact on the future of his/her country. It is sufficient to contrast the demarche of Hugo Chávez in Venezuela with that of Luis Inacio Lula da Silva in Brazil to make the result evident. In those circumstances, the person matters and can change everything, for good or ill.

Mexico is confronting fundamental challenges that will have to be attended to in the upcoming years. The problems of security, economic growth, and political stability will require responses that can no longer be evaded. The new president will be required to take innovative action on these matters. The obvious question is whether he will achieve the necessary transformation without affecting, but rather consolidating, the rights of the citizen and without causing a financial or economic crisis along the way. The intrinsic strength, clarity of course and sense of priorities of the new president will determine the result.

From this perspective, in recent years the notion has taken hold that Mexico is over diagnosed, that all of its problems are known and that it would be sufficient for Congress to agree to emerge from the present gridlock with no further ado. However, while it is apparent that the problems besetting the country are quite clear, I do not believe that a consensus regarding the causes exists; thus, it is impossible for all of the proposals for a solution to be equally viable. In addition, Mexicans are very prone to intermingling causes and symptoms.

In nominal terms, the problems facing the country are sufficiently clear. They concern, in great measure, impediments to the growth of the economy as well as the lack of functionality of the political system. This mixture has created a scenario in which Mexicans have experienced poor economic development, a substantial informal economy, the security crisis, and a permanent political din.

Perhaps the greatest problems and main source of contradictions lie in the political sphere, where they eventually manifest themselves in decisions and actions that impact the economy and other ambits entailing governmental action. For a political system to function, all actors must feel that they are participants and perceive benefits in participating. The PRI system resolved this issue of power in the 1930s with the carrot and the stick duo: the promise of access to power and/or wealth for whoever remained loyal to the system and the president, while severely punishing any disloyalty. That system collapsed in the 1980s, giving way to the era of unsuccessful encounters and conflicts in which Mexicans live today.

Nowadays the country requires a new political arrangement that is inherently compatible with an active citizenship, regular electoral competition and democracy. The system that was forged 80 years ago ceased to function because it did not adapt. The country needs a new arrangement that sets rules of behavior among the powers that be: the political parties, the political forces, the citizenship. It could be as ambitious as what the writers of Federalist Papers envisioned or as modest as what Plutarco Elias Calles, the founder of the PRI, articulated in 1929 to pacify the country, reduce the incentive for conflict and engage all the political forces in a single entity. The paradox is that achieving this exacts great clarity of vision and operational capacity that leads to the institutionalization of power. That is,

agreements on power do not come about by osmosis, but instead are the result of effective leadership that translates into capacity for political action. This does not happen the other way around; institutionalization is the product of coherently articulated agreements.

In Mexico the transition to democracy has been so drawn out and complex that there isn't even an agreement on when it began or how it should conclude. Unlike the situation in Spain, here there was no agreement on the procedures, thus the sole measure has been the result. With a country divided more or less into thirds (the history of the past two decades), the only possibility of advancing—save for an imposition—lies in the creation of a mechanism that guarantees fair distribution of the benefits of exercising power, independently of who wins the elections. Unfortunately, our system of proportional representation does not guarantee this.

Each of the political parties is experiencing real restrictions: the PRI has not been reformed and continues being dependent on many of the most recalcitrant interests that impede any change. The PAN commingles sufficient dogmatic and anti-PRIist elements to render any understanding with its historical rival highly difficult. The PRD evinces an irreconcilable rift between the ex-PRIists who continue living in the Echeverría-Lopez Portillo era of the '70S, and a modern and emerging social democracy. The recent decision by Andrés Manuel López Obrador to form his own party may constitute an extraordinary opportunity for PRD to reform itself. However, only a grand coalition would empower the strengthening and privileging of each party's groups and leaderships that retain a positive view of the country's future, leaving behind all who remain lost in contemplation and harbor old dogmas that will never be the reality.

There are two ways to conceive a promising future. Spain's example embodies a grand agreement on procedure. In the case of that nation, the agreement consisted essentially of the preservation of the Francoist legality until a new constitution and the electoral and political processes derived from it were approved. That is, a *procedure* was agreed upon, not an objective.

Mexico's history of the last two decades demonstrates that an agreement similar to the Spanish one is impossible. First, because experience, above all that of 2006 and now 2012, shows that enough non-loyal or semi-loyal opponents remain to reduce the legitimacy of elections. Second and more



important, in Mexico—in contrast to Spain—there is no experience or history of civilized behavior (even under an authoritarian regime); in any case, Spain's dictator died and in Mexico the same party persists. Mexicans need to break with the past without endangering stability or the chance of a better future. As it happens, it is the very party that created the authoritarian past that will have to fix the problem.

For these reasons, given the country's presidential system, only a coalition government would countenance the splicing together of all the political forces, conferring true representation to all of Mexican society and forging the construction of agreements within the government as a means of consolidating an effective transition platform that breaks with the paralyzing inertia of the present and confers full legitimacy upon the new government.

What has changed?

The political and legislative paralysis of which Mexicans complain so much reminds me of the “laboratories of democracy” described by Justice Louis Brandeis. He argued that it is impossible to set rules for everything; therefore, you have to let things flow and find their place, so that experimentation leads to finding the best way to bring about the development of a society. Sometimes I think the Mexican interpretation of such a laboratory ended up producing something more akin to Dr. Moreau's Island, the H.G Wells novel in which horrific vivisection experiments mixed men and beasts.

For starters, I believe the country has confused democracy with paralysis. If one refers to paralysis only in terms of the legislative process and the relationship between congress and the executive, then it is clear that the alleged paralysis was first noted when the PRI lost its legislative majority in 1997. The then-new Congress wanted to distinguish itself from its predecessors by failing to comply with the wishes of the almighty presidency of old. In fact, 64 constitutional decrees were approved in the 15 years since 1997, compared with 42 in the previous 15 years. Paralysis is a myth.

What has certainly changed is the fact that presidential initiatives are no longer approved right away and some never are. Beyond the figures, it is obvious that the country requires significant changes in several areas and almost none of these have thrived in Congress. That is, although Congress has been overly active, the country has spent years waiting to amend laws on economic issues and on political institutions. This failure to advance on

crucial reforms has led to another myth: that progress can only be achieved when the president holds a legislative majority. This, in a country where there is no agreement even on legislative procedure.

However, I hold a differing view. First, the country's problems have nothing to do with the existence of legislative majorities. Therefore, assuming that the mere fact of the existence of a majority would solve the challenges of development is not just a chimera, but also a form of self-deception. Second, the fundamental problem lies in the astonishing lack of capacity for political maneuvering displayed by the last three administrations. The belief that all problems could be solved with a one-party legislative majority is, to say the least, infantile. It implies assuming that with the PRI back in government, the old political structure of control can be reconstructed by the mere fact that one party controls both the presidency and Congress. At issue is whether the legislators who discovered their independence of the executive in the past 15 years would be ready to become submissive to the president once again. The political reality rendered by the recent elections make it necessary for a multiparty coalition to be formed. As was stated earlier, the question is whether Peña can build such a coalition. Much is riding on that.

Throughout history, the world has been constructed, and more than once nearly destroyed, as a result of alliances both sacrosanct and sacrilegious. Alliances and coalitions are the essence of power. The ancient monarchies procured political marriages that expanded or consolidated empires, while modern parliaments construct coalitions in order to function. Independently of the objective that a specific coalition might pursue, the world stays in motion with power-sharing accords.

In the last two decades, Mexico has been an exception to this rule. Although there has been a great deal of legislative activity, the country has witnessed a political class that is practically incapable of making a commitment and acting on the core challenges Mexico confronts, which in turn have translated into critical foot-dragging in matters above all economic. There have been an infinite number of reforms relative to social and political rights, but none relevant in the themes that impede the type of economic revolution that our main competitors on the global scale have experienced.

The explanation for this situation is obvious: the PRIist pact that sanctioned decades of stability in the last century collapsed due to the erosion

that inexorably accompanies the exercise of power and, to no small degree, due to the evolution of Mexican society during this same period. The agreements of the 20s with which the grandfather of the PRI, the National Revolutionary Party, was born, were primitive, but were in sync with the post-revolutionary moment. In their essence, those compacts commanded respect for the top leader and cacique (jefe máximo) and his successors every six years, a presidential succession procedure and a mechanism for the distribution of benefits tied to the loyalty of players to the leader and to the system at every point in time. That pact finally collapsed in the 80s when the party divided and the instruments that had furnished cohesiveness for the political class (PRIist) vanished. The 1997 and 2000 defeats were nothing but coups de grâce to a system that had stopped functioning and that, beyond nostalgic intimations, cannot be reconstructed.

Since the end of the 1980s, the country has functioned, poorly or well, depending on the dexterity and political operative capacity of the individuals who have occupied the presidency. Salinas, a skillful and shrewd politician, knew how to use the instruments of power, while his successors did not; by the same token, the absence of checks and balances ended in political violence and a catastrophic financial crisis. In frank contrast with previous decades, the “system”—which had permitted political functioning independently of the abilities of the individual at the helm stopped working. Our paralysis is not the product of coincidence.

The problem is, then, one of the organization and administration of power. The genius of the PRIist system consisted of its constructing an authoritarian mechanism that, due to its nature, became an institutional structure that was perceived as legitimate. What’s needed today is an institutional construction within a competitive and democratic milieu.

The PRIist structure worked around the PRI-President binomial that implicated internal negotiations with a great capacity for implementation. The PRI, as political control system, allowed guaranteeing that the decisions arrived at from this binomial could be instrumented. It also incorporated disciplinary mechanisms that permitted marking off at least the worst forms of excess and abuse by public officials, union leaders, and politicians in general. The most evident consequence of that authoritarian and centralized structure was that it never fathomed the construction of functional in-

stitutions because these would have delimited the power of the center. This is the reason for the brutal weakness of the state governments, a factor that has made possible, with the collapse of the central control, the constitution of primitive replicas of the old system at the state level.

The answer is not to recreate the old PRI-dominated political stem. Instead, Mexico needs to create a system that could deal with at least three major shortcomings of the current system: first, it would have to legitimize both the winner and the opposition; second, it would have to allow for power to be shared in proportion to each party's showing in elections; and third, it would have to build mechanisms to exact accountability from the state governors. This list implies that the real challenge of Mexico today is to build a foundation for the exercise of power within a properly functioning system of government that includes checks and balances.

The most obvious way to do this is to get the major political forces in the country to forge a compact among themselves. This is not very different from what the PRI accomplished early in the 20th century. The old PRI system operated on the basis of a series of arrangements among the then-victorious clique that ended the revolution. Those arrangements ended up institutionalized and became the core of the functioning of that system for decades. In essence, since the 1920s, the PRI has accomplished an extraordinary feat. It legitimized the structure of power, established a spoils system and maintained the allegiance of the population at large. Those arrangements eroded over time and disappeared when the PRI lost the presidency. Given the fact that a new pact was not forged when the Fox government had the upper hand in 2000, the only way to arrive at such an arrangement is through an extraordinary exercise of leadership. Great leadership—like that of Adolfo Suárez in Spain or Nelson Mandela in South Africa—can do miracles, but it is no substitute for checks and balances. Peña's challenge is enormous, but so is the opportunity.

With the new administration, Mexicans are about to see what a PRI back in power will attempt to do to make the country governable and what risks it is willing to entertain to get there.

In Mexico, the only law that rules is that of gravity.  
And not always.

—ANONYMOUS

## V. Decentralization and Its Consequences

Myshkin, the erudite, coarse and naïve hero of Dostoyevsky's novel *The Idiot*, arrives at an important party, obsessed with not breaking the Chinese vase in mid-salon. He attempts to maintain his distance from it, but, no matter how much he tries, he ends up destroying it. The episode could be a snapshot of the political transition that Mexico has experienced. The objective was to construct an idyllic democracy that would foster development of the country and civility in Mexican society. The result has been political paralysis, a rising level of social conflict, ill-will, a poor economic performance, and, to top it all off, generalized pessimism.

The issue, however, is not about what went wrong, but rather, about the pressing need to recognize that there have been unanticipated consequences of Mexico's transition, many very serious, which have to be dealt with. An obvious question is whether we are dealing with a sliding slope or with the necessary pains that lead to a citizen-based and accountable democracy.

These are the consequences of an ill-planned (actually, *unplanned*) transition from a tightly controlled, centralized structure of power to an undefined objective. All that was organized was an effective mechanism to guarantee clean and fair elections. The rest would somehow follow automatically. Probably the worst part of that process was that there was no explicit definition of an objective to which all political forces were committed. Hence, today, there is not even an agreement on the diagnosis of the current situation or of what needs to be done.

Beyond objectives or good intentions, the political change that Mexico has experienced has mainly manifested itself in the decentralization of power. From the erstwhile omnipotent presidency, the country moved to a new political reality: that of actors, formal as well as informal, stockpiling power and resources with no responsibility whatsoever and without even minimal checks and balances. As has been said before, power migrated

from the president to the state governors, political party leaders and many special interests. The intricate web of tentacles, which the Institutionalized Revolutionary Party (PRI) had created and which served to maintain control, collapsed with the defeat of PRI, causing many of its components to spin off to become what Mexicans call “de facto powers,” or power strongholds—unions, business groups, political cliques—that are impermeable to any democratic check and that have the power to derail legislative, political or enforcement actions that might affect them. What they all have in common is their distance from the citizenry, their lack of accountability, and, for all practical purposes, the absence of checks and balances.

The consequences of this new reality can readily be noted in all ambits, but are particularly apparent in the pathetic performance of the economy, the lack of public safety and the permanent conflict that characterizes all public forums. The country benefited from the transition because it ended the systematic abuse inherent in the centralized government of the past. However, the costs have been significant and the risks related to unemployment, social conflict, violence and disenchantment are on the rise.

The economic costs have been extraordinary. The decentralization of power, which began, piecemeal during the 1980s and mushroomed over the past decade after the defeat of the PRI, was accompanied by the transfer of public resources. Conceptually, no one can dispute the fact that in a democratic system, resources are administered by the representatives of the populace and, without doubt, the state governors and municipal presidents are the public officials closest to the citizenry. The problem is that the concept does not square with the reality. In the first place, the overwhelming majority of revenues are collected by the federal government and not by state and municipal governments. Secondly, real, effective mechanisms for checks and balances do not exist for the state and municipal governments. This has always been a problem at the federal level, but now it has expanded to the other levels of government. Finally, resource allocation has translated into much less efficient and effective expenditures, and, by extension, into a lower rate of economic growth.

Before, in the Golden Age of centralization of fiscal resources (the 1950s and 1960s), Mexico’s Department of the Treasury had at its disposal enormous resources that it generously applied to development projects. The

so-called “bolsas,” residual monies left over after paying for overhead expenditures (salaries, rents, administration costs), constituted an enormous portion of public funds and were employed to promote regional development, essentially through the construction of infrastructure. One year, the decision was made to electrify the southeastern region of the country; in another, to build a highway to Queretaro; and in another, to construct Cancun. The Federal Government conducted cost-benefit analyses of each project and generally decided in favor of those offering the best potential for raising the general economic growth rate. Centralized executive power, enormous piles of cash and the capacity to enforce developmental decisions produced a significant economic impact: the average growth rate in those years was close to 7 percent per annum, with less than 2 percent inflation. The success of that system began to decline when society began to demand more rights (as with the student movement of 1968) and, most important, when the economy began to underperform around 1970. As will be argued in the next chapter, the government’s response to economic underperformance in 1970 proved catastrophic, for it brought high levels of debt, inflation and, ultimately, more social conflict.

The dispersion of resources, which is the norm at present, possesses very different characteristics. There are very few governors who do economic cost-benefit studies. Rather, their criteria are personal, electoral and political benefits, usually in that order. Whereas in the past the president controlled both the resources and access to power, today each governor sees his term as an opportunity to launch his candidacy for the presidency. Hence, public monies are used to enhance each governor’s image, build projects that are visible but not necessarily relevant or aimed at triggering economic growth and, most important, to stockpile hordes of cash for an eventual campaign or for retirement in case their political aspirations fail. The result has been much greater corruption and opacity (which benefits the governors) and much less economic growth (the only way that more jobs can be generated for the average Mexican). Stated differently, the population has lost and the politicians have won.

The security crisis is a second consequence of the decentralization of power and resources. The resources, functions and responsibilities that were decentralized to the states were never adopted by the governors as their



own. In particular, virtually no state or municipal government has built the judicial and police structures that are needed to maintain peace and enforce the law. And almost like a curse, this transition happened precisely at the time when the criminal organizations were expanding in Mexico for reasons of their own. This is not to say that the former security scheme worked well, but decentralization had the effect of destroying what existed without putting anything in its place, with certain trifling exceptions. The result is the chaos in security that presently exists; its essence has nothing to do with narco-trafficking proper, but instead, with the fact that organized crime plagues the entire nation due to the absence of any effective intervention by the police or judicial institutions.

Given the weakness of both the judicial and police institutions throughout the country, and without decisive action on the part of the federal government, it is inconceivable to expect to successfully confront organized crime. However, to create some form of coexistence, social harmony and control of criminality, there is no alternative to a strong local government endowed with the appropriate and relevant instruments for battling crime. Neither of the two efforts is sufficient in itself, but without the local efforts, success is impossible. The problem is that the country has never had, at least since the Mexican Revolution (1910–1917), strong local government. The old PRI system was not set up to include an effective state and municipal government. Instead, it was created to control politically active groups at all levels of government and society, and the population in general. That system never developed an institutional capacity that would make it possible for the society to organize or act independently. In fact, its specialty was to sever the head of anyone attempting to do so. Observed in retrospect, this is the heart of the conundrum that Mexicans are living under at present. The botched transition of the past decade needs to be reconceived to advance toward a political arrangement that can deliver both stability and better economic performance.

Each political transition is different, but only a few end well. Those that are triggered by the death of a dictator force all political forces to reckon with a new reality, an imposed break with the past. The Spanish transition is the epitome of a negotiated transfer of power, but it is quite obvious that the dictator himself had built some of the scaffolding necessary for that to

happen. At the end of the day, Spain took a course that does not resemble what Franco had designed, but it established a model that others want to emulate, though few have succeeded in doing so: there are many more dictators than successful transitions.

No agreement exists on when Mexico's political transition began or of what it consisted, but it is evident that the successive electoral reforms that were implemented between 1978 and 1996 had the effect of favoring increasingly even-handed electoral competition (which produced an ever-growing number of non-PRI state and local governments), until the PRI was finally defeated in the presidential election of 2000. If the objective of the transition was to defeat the PRI, the transition was successful. If by transition one means the founding of a modern, more egalitarian and civilized country, the transition has been a disaster. It suffices to read any newspaper or watch the newscasts to see a nation that has become progressively bitter and in conflict with itself. The problem lies precisely in that the transition confined itself to the electoral arena, leaving everything else to chance. In a nutshell, Mexico's political transition was unplanned and is incomplete. My assumption is that only strong and visionary leadership can make this change.

In Mexico's case, part of the problem is that there was no break with the past. With amazing shortsightedness, President Vicente Fox (2000–2006) failed to use the historic opportunity that his election had produced to redefine the political compact of the country, force the members of PRI to adjust to new rules, submit the “de facto powers” to the rule of law and launch a negotiated, peaceful transition. Fox simply assumed that he was the transition and everything else would follow. The result was no break with the past and, worst of all, no agreement among the “powers-that-be” on the path to follow.

Perhaps the greatest of the costs generated by Fox's failure to act is that everything in Mexican politics continues as before, except for the robustness of the presidency. That is to say, with the defeat of the PRI, the presidency lost its principal instrument of control and action. Everything else, however, continued the same: the contempt for the law; governmental and police corruption; and administrative as well as criminal impunity. Instead of a government, we have developed something akin to what Sicilian novelist

Giuseppe Tomasi di Lampedusa described in his great novel, *The Leopard*: The political elite pretends to change so that everything can remain the same. No wonder the country has failed to move forward.

The big question is how to correct the present situation. The ideal countries to imitate (such as Spain and Chile) are no longer replicable; the opportunity for a negotiated transition from the very beginning is no longer an option for Mexico. The alternative today rests on either the citizens forcing the politicians to act or for the politicians to act on their own. The former is not an easy thing to accomplish, and less so in a context where two apparently contradictory processes are occurring: (1), a relatively good economic performance (in fact, Mexicans are rapidly becoming middle class); and (2) a very tense situation produced by the wave of insecurity and violence affecting various regions of the nation. It is important to note that though power has become decentralized, the governors and the “de facto powers” now concentrate power and, often, wealth in their regions or sectors. As a result, while people are free in many ways, they do not have the means to provoke change or the incentive to break away from their comfort zone.

Clearly, Mexico needs a new institutional structure, one that transforms (or, rather, breaks from) the old PRI-based entities to create a citizen-based political structure that can work. In fact, there are several proposals and bills in the Congress that point precisely in that direction. A few visionary politicians are leading the charge. But the political debate is going in the opposite direction. What seems certain is that the future will be shaped by the actions or inactions of the next administration. Weak leadership, such as is evidenced in the situation that Mexico has experienced since the mid-1990s, would create further disorder. A strong leader would shape the future in a way that could equally lead to centralizing power (which is unlikely to work as history proved both at the beginning of the 20th century and in the 1990s) or to strengthening political institutions. Therein lie the pitfalls of strong leadership—it entails an enormous risk of ending badly.

If one observes similar countries, such as South Africa and Brazil, that have been successful, it seems obvious that Mexico needs both a strategy and enlightened leadership. The transition that the country embarked on in the past two decades was no more than a bet that things would work out, but ended up being a collection of good intentions and remarkable

arrogance. Mexicans must now deal with the consequences. If recent history is of any value, it teaches that depending on leaders is not a good way to accomplish an institutional transformation. Although there are a few exceptional successes, most have been dire failures. The question is what is the alternative? That is where Mexico is today: hoping that the next presidency will be enlightened enough to produce the desired outcome. And that is the conundrum Mexicans find themselves in and, most likely, the prime reason a plurality voted for the PRIista Peña-Nieto and his promise of effective government.

Enrique Peña-Nieto, himself a former governor, will have to begin by defining what relationship he wants to hold with the governors. One possibility would be to establish rules and means of accountability for the status quo. The other would entail a significant recentralization of power. One may assume that because he has been a governor, he would see strong (and rather autonomous) governors as the nature of things. However, there are several reasons to think that he will do exactly the opposite. One has to do with the very essence of power in an institutionally-weak society; having more is always desirable for politicians. More important, however, is the fact that state and local institutions have proven to be extremely weak and corrupt. Violence and insecurity in general have a lot to do with the weakness of local authorities and there is no reason to expect that things could change in this regard. Hence, it sounds plausible that the President's agenda will include new rules with the governors and an attempt to restrict budget transfers to them. It will be an interesting confrontation to watch.

On one occasion, Montesquieu affirmed that "there is no crueler tyranny than that which is perpetuated under the shield of law and in the name of justice." In Mexico, we must start by eradicating the tyranny of excess, abuse, and the absence of checks and balances for the rule of the law to begin. Politicians and leaders have a part to play, but citizens will have to learn to force them to be accountable. This will not be easy to accomplish.

As much as thou hast so much art thou worth, and  
as much as thou art worth so much hast thou. As a  
grandmother of mine used to say, there are only two  
families in the world, the Haves and the Haven'ts.

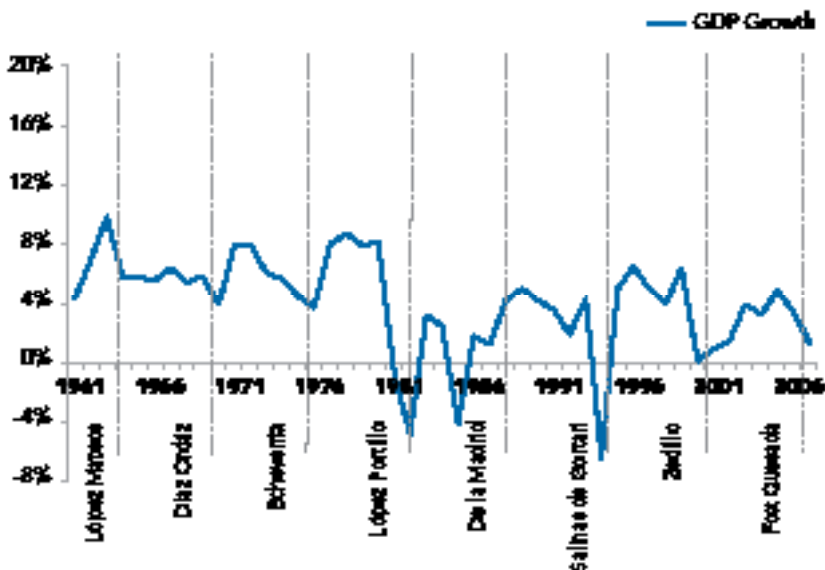
—MIGUEL DE CERVANTES Y SAAVEDRA, *DON QUIJOTE*,  
CHAPTER XX, SECOND PART

## VI. A Slow but Mushrooming Economy

Mexico's economy has experienced over 40 years of reform-led convulsion, but has yet to consolidate its gains and transform itself into a wealth- and job-creating machine. In the ongoing debate about how to address its deficiencies, a variety of proposals have been made: more spending and less spending, economic liberalization or more protection vis-à-vis imports, programs to attract foreign investment and others to regulate it. The prescriptions are many and many have been tried, some of them with catastrophic results. And yet, after years of reform, financial stability and private investment, the economy muddles through, delivering fairly high rates of growth (5 percent in each of the past two years) and extraordinary numbers of created jobs. In fact, the economy is beginning to enjoy the benefits of two-odd decades of investments, both institutional as well as monetary, that are beginning to pay off. One wonders how much more could be achieved under strong leadership that is capable and willing to exploit these investments and eliminate the many remaining obstacles to higher growth rates.

Anyone looking at the past would be hard-pressed not to be aware of the depth of the change the economy has experienced over the past quarter century. From a closed and protected economy, the Mexican economy was liberalized and subjected to the forces of world competition; from an expropriated banking system, it underwent a process of privatization, then crisis and then sales, mostly to foreign financial institutions; from an internal market heavily dependent on public expenditures, the economy has become widely integrated into the world economy. However, all of these changes and reforms have failed to achieve the openly acknowledged objective of reaching high and sustained rates of economic growth. The economy has performed better than most in the world over the past three years, which suggests that the measures taken over the past two decades are starting to deliver. Yet the rates attained are well below the requirements for job creation.

## GDP Growth



*Source: Author, based on data from Timothy J. Keboe and Felipe Meza, *Catch-up Growth Followed by Stagnation: México 1950–2010*, Federal Reserve Bank, 2011 (data from Angus Maddison and World Development Indicators).*

Failure to reach sustained levels of high economic growth constitutes a symptom of the structural problems that characterize the economy. However, this hasn't been due to lack of trying. From Echeverría in 1970 through Felipe Calderón, every administration's prime concern has been growth. Each president sought a response in his experience, preferences and imagination. Each of the responses has been different: all that they share is that none has been sufficiently successful to achieve the avowed objective. Concern for the problem has been a constant but the responses have been inadequate or have fallen short.

In essence, the old political system that in many a way has changed little under the two PAN administrations—has been reluctant to recognize the depth of the changes taking place worldwide and has put up as

many obstacles to reform as possible. NAFTA, probably the most visible component in this process of reform, is telling in itself. Whereas NAFTA should have been the beginning of a profound process of transformation and adaptation to exploit the market access to much bigger and productive economies, the reality is that Mexicans saw NAFTA as the end of an era of reform, as a means to consolidate what had already been accomplished. The result has been a bifurcated economy—one competitive and characterized by extremely high levels of productivity growth, the other stagnant and uncompetitive, but responsible for a huge proportion of the industrial labor force—that holds the economy down.

This chapter delves into the transformation that the economy has experienced, the dynamic of reform and the consequences of unfinished modernization. It also discusses the issues at stake and the nature of the dilemmas that will have to be confronted.

## WHERE FROM?

Mexico's economy grew at an average rate of 6.6 percent for decades until the late 1960s, with low levels of inflation, fiscal accounts in balance and virtually no debt. Economic strategy was based on sound fiscal and financial principles and on an import substitution policy that promoted the growth of a domestic industrial base. Imports of machinery and raw materials were financed with exports of minerals and grains, as well as with inflows of foreign investment. That success story suddenly changed at the beginning of the 1970s.

A relatively minor slowdown in 1970 produced a major shift in economic policy as Echeverria chose public expenditures as the driving force of economic growth, financed with foreign debt and inflation. The shift in policy was a response both to the slowdown as well as to a student movement that had shaken the political foundations of the country in 1968. The government wanted to stimulate economic growth, incorporate the dissenting students into the political system and strengthen the role of government in the economy. Ten years later the country was over indebted and the economy had collapsed. When crisis struck at the beginning of the 1980s, the country had no choice but to begin a reassessment process.



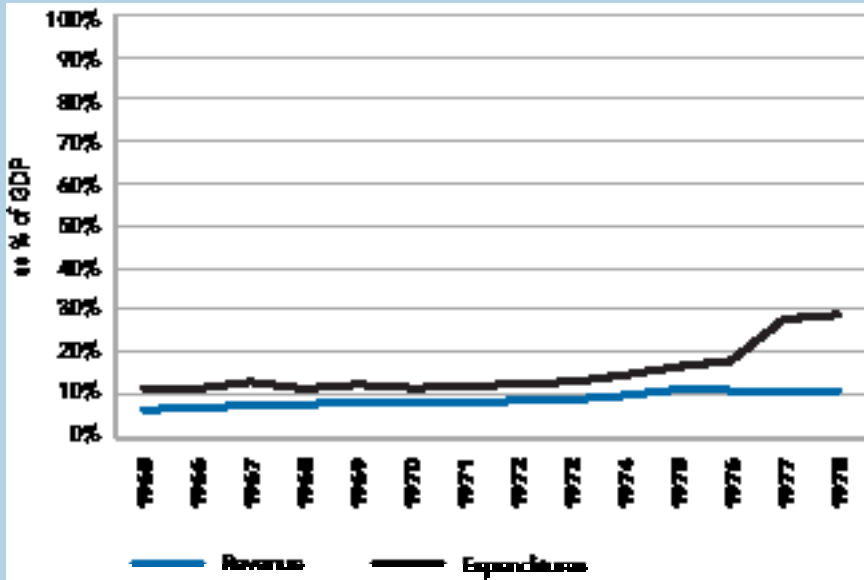
When the economy first experienced a minor slowdown at the beginning of the 1970s, the debate within the government recognized that the economy was stuck and that it required a series of changes to avoid a balance of payments crisis (particularly because the crisis had been produced by the collapse of grain exports that in the previous decades had financed imports of industrial inputs). The choice that the Echeverría administration (1970–1976) made on how to address the economic challenge proved fateful.

In contrast with the proposal to begin a gradual liberalization of imports to increase productivity and force the Mexican economy to compete, Echeverría decided to break with the fiscal and financial orthodoxy that to that time had been the mainstay of economic policy and decided to launch a growth strategy based on public spending. The economy responded immediately, but soon began to experience a phenomenon hitherto virtually unknown in the country: inflation. In retrospect, the way Echeverría responded to the slowdown proved brutally costly. López-Portillo (1976–1982) returned to orthodoxy as a means to restore growth but the then recently discovered oil fields made it easy to return to the Echeverría policies. At the end of his term, the country's economic structure had experienced a serious decline, financial imbalances were extraordinary and the country entered a decade of near hyperinflation.

The day of reckoning came at the end of 1982 when a new administration found itself in virtual bankruptcy. The economy was contracting rapidly, government spending exceeded income dramatically, foreign debt had soared and, if all this were not enough, the outgoing president, José López-Portillo, had expropriated the private banks, depriving the economy of one of the instruments for eventual recovery. Although the incoming administration (Miguel de la Madrid, 1982–1988) implemented a series of stabilizing measures to restore a fiscal and macroeconomic balance, these proved to be insufficient for restoring growth. What the de la Madrid administration did accomplish was creating the stage for a series of more ambitious reforms that would begin a few years down the road.

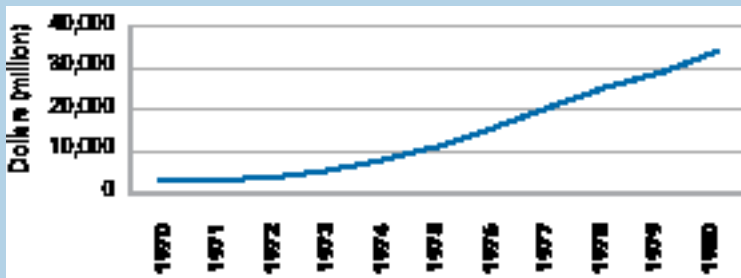
Miguel de la Madrid attempted to return to the stability of the 1960s, only to find that the new circumstances made it impossible. It was not only that the country was highly indebted and that many companies were facing dire prospects, but that the old prescriptions for recovery were no longer

### Revenue vs expenditures (1965–1978)



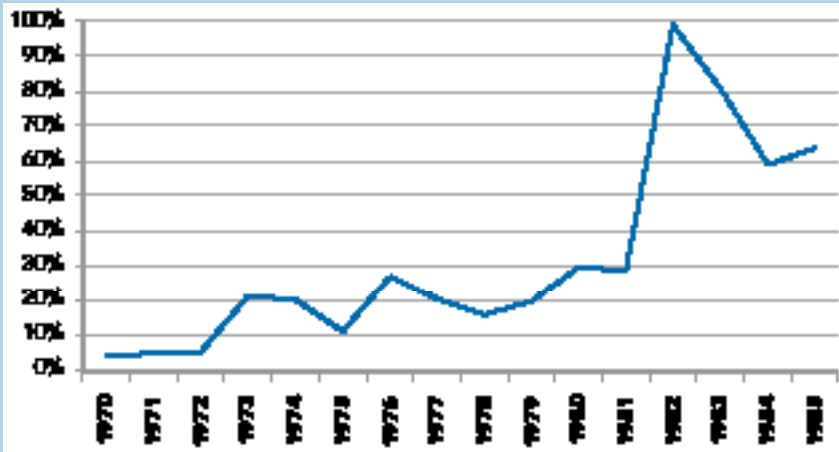
Source: Macario Schettino, *Cien años de confusión: México en el siglo XX*, Taurus, 2007, p. 392

### Public Debt



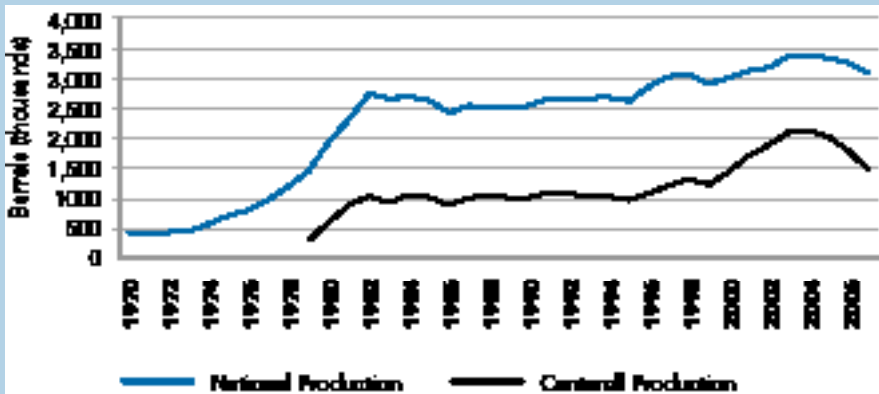
Source: CIDAC, using data from *The World Bank*

### Inflation (1970–1985)



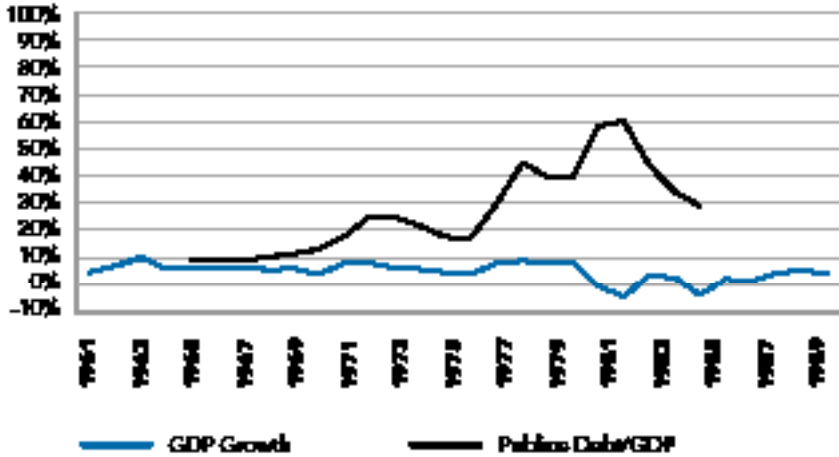
Source: Author, with data from INEGI

### Daily Oil Production



Source: Macario Schettino, *Cien años de confusión: México en el siglo XX*, Taurus, 2007, p. 440 (with data from Sistema de Información Energética, Secretaría de Economía and Estadísticas históricas, INEGI, 2009)

## GDP Growth vs Public Debt



Source: CIDAC, with data from Timothy J. Kehoe and Felipe Meza, *Catch-up Growth Followed by Stagnation: México 1950–2010*, Federal Reserve Bank, 2011 data from Angus Maddison and World Development Indicators) and The World Bank

relevant. The real issue was that the world economy had radically changed during the 1970s (largely because Japan transformed its industrial base and created the modern industrial model based on high specialization and geographic dispersion of production) and, more importantly, because the domestic industrial base could not compete due to being so isolated.

The reforms that began in 1985 were largely the product of a government faced with economic paralysis. After three years of intense reform of government finances, growth had failed to materialize. In a very tentative manner, an unconvicted administration launched two major initiatives: first, it privatized some entities—from 1982 to 1994 the number of government-owned entities decreased from 1,155 to 210<sup>1</sup> (many of which had fallen into the government fold due to price controls); and, second, it

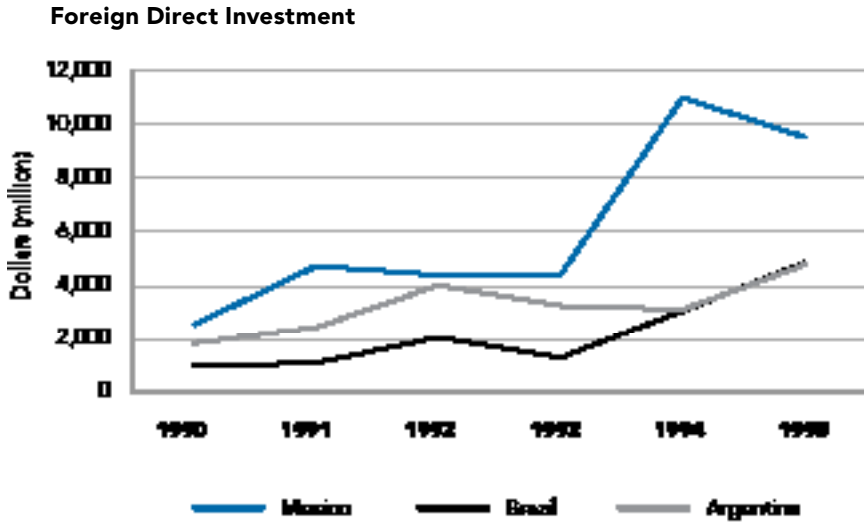
1. Gerardo Esquivel and Fausto Hernández-Trillo, “How Can Reforms Help Deliver Growth in Mexico?” in Liliana Rojas-Suárez, *Growing Pains in Latin America*, Center for Global Development, Washington, D.C., 2009, p. 209.

negotiated Mexico's entry into GATT and liberalized imports, though at relatively high tariffs. These measures were intended to raise the productivity levels of the economy and to force the domestic productive plant to cater to the consumer. Slowly at first, de la Madrid unleashed a true revolution.

With these measures, Mexico decided to abandon the development model based on the subsidy and protection of producers in order to put the consumer at the center of the economy. This decision was based on experience: decades of protection had not translated into a strong, vigorous, and competitive industry. The Mexican manufacturing industry—with many notable exceptions—had grown stagnant. Much of the improvement in the well-being of the population since the 1990s has been the result of the competition introduced by those liberalized imports from the 1980s on. Today Mexico has a hypercompetitive industrial base that, on the whole is far more successful than its Brazilian counterpart. The result for the country—albeit not for all individual companies—has been positive.

Carlos Salinas continued the same strategy, but quickened the pace. Various companies and banks were privatized, NAFTA was negotiated and foreign debt was restructured and brought down to manageable levels. Private investment, both domestic and foreign, rose, but achievements in terms of economic growth remained marginal. Although changes and reforms had been many and ambitious, they ended up being insufficient because they did not affect the key interests of unions, private conglomerates and politicians. The paradox of that strategy, which continues to haunt the economy today, is that protecting some interests ends up creating unsustainable economic and political consequences. Zedillo, Fox and Calderón left most of those same interests untouched, thus delivering relatively poor rates of economic growth in return.

Although the governments of the past four decades certainly had the clear objective of raising the growth rate of the economy and broke down many historical taboos along the way, their success has been limited by the imperative of not affecting the PRI political power structure and the economic interests that thrive around it. Paradoxically, two PAN administrations actually followed the same restrictions in the way they decided to act. That is, the reform strategy has had as an absolute limit not touching those deeply entrenched interests. Thus, not affecting the corporatist structures



Source: Carlos Alba Vega, *México después del TLCAN. El impacto económico y sus consecuencias políticas y sociales*, Foro Internacional, vol.43, no.1, 2003.

of old made it impossible for these non-PRI governments to alter the economic course and produce better economic performance. The economic reforms have been guided by the imperative to change only what's necessary in order not to touch the essential.

## WHERE TO?

The journey has been long, but the destination is still not clear. The very fact of launching ambitious reforms had the effect of attracting investment, thus producing better growth results. However, as the pace of reform waned and the contradictions inherent to the reforms themselves became evident, expectations experienced a shift in the opposite direction. None of this diminishes the actual impact that the reforms have had and the extraordinary transformation that the structure of the economy has experienced, but

what is extraordinary is how many relevant reforms have been carried out with, relatively speaking, such modest results. Despite the latter, Mexico has become a formidable export platform, NAFTA constitutes a comparative advantage, the middle class has grown<sup>2</sup> and become strengthened and the objective of maintaining a fiscal and financial equilibrium has become entrenched throughout the political spectrum.

Despite these successes, Mexicans have lagged behind other nations in both the rate of overall economic growth as well as in the availability of jobs and levels of income. In fact, a world of obstacles remains to investment, impediments that surely explain an important part of the low levels of the growth of private investment. Some of these appertain to history, property rights, arbitrary acts by the government, lack of leadership and, primarily, an irrepressible tendency to change the rules every time something annoys a government official.

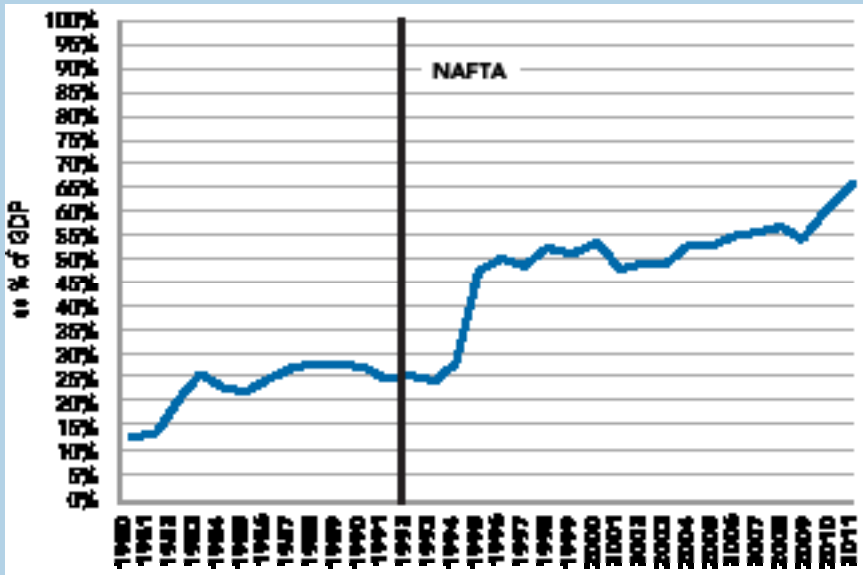
All this reveals an acute institutional weakness that lies at the heart of the six-year cycles of yore: when presidents achieve winning over the confidence of the population, their periods of governance yield better economic returns. That is equally true these days of state governors as well. When they fail at this pursuit, the economic results are meager. This story is well documented, but there are limits to the explicative capacity of the theme of credibility, above all because its relevance decreased with the North American Free Trade Agreement (NAFTA).

NAFTA's core objective was to consolidate the credibility of rules in investment matters. That is, the government that promoted the trade agreement with the U.S. and Canada understood that private investment did not flow precisely due to the problem of trust. The weakness of Mexican institutions makes people and investors rely on individuals, which means that each president (or governor) has to reinvent the wheel to confer a sense of stability on potential investors. With the clear and permanent rules inherent in NAFTA, as well as its credible dispute-solving mechanisms, investment would flow without surcease and growth would be sustained. At least that was the theory.

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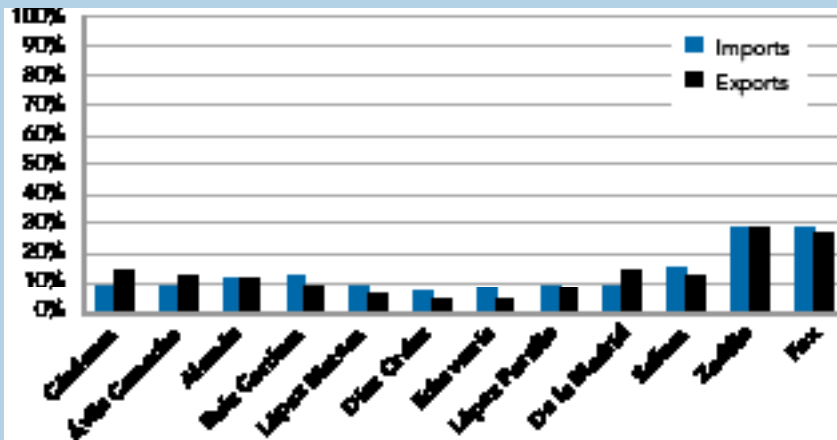
2. Luis de la Calle and Luis Rubio, *Mexico: a Middle Class Society*, The Woodrow Wilson Center for International Scholars, Washington D.C., 2011

### Trade Liberalization (Total Trade Volume)



Source: Jaime Serra, *La Apertura Comercial de México*, SAI Consultores, S.C., 2009 (with data from Banco de México and INEGI)

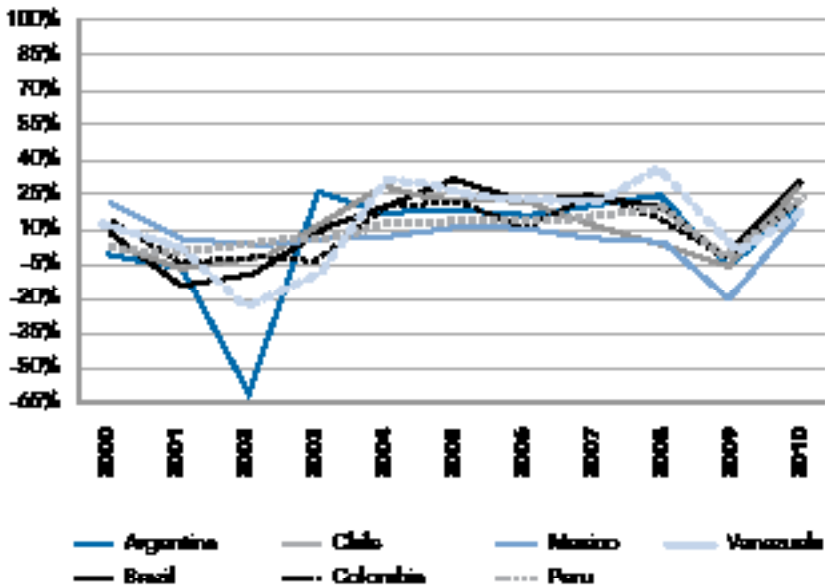
### Foreign Trade as a percentage of GDP



Source: Macario Schettino, *Cien años de confusión: México en el siglo XX*, Taurus, 2007, p. 313 (with data from INEGI, base year 1999)



### GDP Per Capita Growth



Source: CIDAC, with data from The World Bank

In a way, despite NAFTA, Mexicans exist in a sea of contradictions that inexorably exert the effect of generating confusion, of opening spaces for the violation of certain regulations and, at the end of the day, of diminishing the level of investment. In one sense, existing regulations entail contradictions that make it impossible for a company or investor to be sure of the regulatory framework that is relevant to their project, which discourages investment. On the other hand, a company can take advantage of the differences, contradictions, and gaps that remain in place between one regulation and another and wait for the firm's ship to come in. Too many regulations entail inevitable contradictions, but also create opportunities for arbitrage, which is what companies do. The contradictions could be synthesized in the following statement: today we have first-world entrepreneurs but still have a fifth-world system of government. The capacity of the country's

### Residential Telephone Charges (USD PP)

	20 CALLS	60 CALLS	140 CALLS	420 CALLS	COST PER CALL
<b>Canada</b>	\$29.03	\$34.76	\$35.89	\$53.70	\$0.60
<b>Mexico</b>	\$31.83	\$49.85	\$85.39	\$155.09	\$0.85
<b>United States</b>	\$28.45	\$35.77	\$48.89	\$73.70	\$0.64
<b>OECD average</b>	\$25.18	\$36.72	\$59.01	\$95.35	\$0.63

Source: OECD Communications Outlook 2011

### Mobile Telephone Charges

	30 CALLS	100 CALLS	300 CALLS	900 CALLS	COST PER CALL
<b>Canada</b>	\$26.28	\$38.59	\$38.59	\$46.69	\$0.36
<b>Mexico</b>	\$18.00	\$37.37	\$70.80	\$123.15	\$0.34
<b>United States</b>	\$23.25	\$51.13	\$51.61	\$56.63	\$0.38
<b>OECD average</b>	\$16.83	\$33.00	\$62.89	\$122.71	\$0.31

Source: OECD Communications Outlook 2011

economy to grow depends on the strength of the companies, but this will always be restricted by the power of a vile bureaucracy whose rationality is not concerned with growth of the economy, generation of employment, or enrichment of the country.

Delays persist in economic matters and the inputs supplied by many state companies, above all PEMEX and CFE, are not price-competitive or dependable with respect to their delivery times. Similarly, numerous activities continue to be protected, giving them the dubious privilege of not having to compete. The result of all these evils is that the overall economy is less competitive than it could be, and that rather than generalizing the benefits of the successful portion of the economic activity, these tend to concentrate. But what cannot be ignored is that today thousands of companies are ultracompetitive and, little by little, these are changing the face of the economy.

The practice has been two-fold: on the one hand, investment has flowed with no end in sight, which explains, to a great degree, the strength of the export sector. On the other hand, export-oriented investment benefits the internal market very little, largely because there are no domestic supply chains that feed into export manufacturers; thus, the economic impact of exports is much less than it could be. That is, NAFTA resolved the problem of the economy with respect to the exterior, but didn't modify the domestic market's dynamic. There we find that ways of producing and distributing goods and services that have nothing to do with what is happening in the rest of the world continue to persist. There the Mexican economy continues to be closed and protected, products and services are often highly priced and inferior in quality, and businesses continue not to adapt to world-class competition.

This dichotomy lies at the core of the country's manufacturing ills. The tangible fact is that Mexico has two very different economies: one is focused on productivity and exports, while the other is entirely focused on the internal market. Typically, companies in the former compete with the best in the world, while those in the latter live precariously, protected, in some cases, by tariffs and subsidies. While many of those in the latter category relish formal protection, the majority are protected by traditions and ancestral forms of consumer behavior. Companies producing goods that consumers can easily exchange for imports (like microwave ovens) had no choice but

to adjust or die; companies in which the store or contractor determines the supplier (like electrical or plumbing installations) have adjusted only in some instances. The result is a hypercompetitive, export-oriented industrial base living next to a gradually dying old manufacturing sector.

An amazing feature of Mexico's governments over the past half century is that there has been no program or policy to help develop a link between the export sector's hypercompetitive economy and that of the internal market. And this explains the reason why, in contrast with other countries, the multiplier effect of exports on internal economic growth is much less in Mexico than in the U.S. or in Brazil: while every dollar exported adds 1.3 dollars of growth in Mexico, the number is 2.3 dollars in Brazil and 3.3 dollars in the U.S.<sup>3</sup>

Mexican business leaders often speak of production chains, by which they mean, at least conceptually, the need to link the internal with the export economy. Before imports were liberalized in the mid-1980s, Mexican producers were linked in chains as in other countries: some produced parts and components, others sold assembled products. Those productive chains died the minute some companies understood that in order to increase their productivity levels and profitability, they needed to import the best inputs. The government assumed that, over time, new productive chains would grow and develop, but this has largely not happened. Liberalization broke with the then-existing productive chains because it allowed new suppliers to enter the system. These new suppliers made it possible for many companies to become competitive, thus capable of competing with imports and to export.

Domestic suppliers who did not regroup lost out because they were incapable of competing due to lack of ability or desire to attempt it. The theory that domestic industrialists would become the suppliers of exports, as occurred in Korea, simply did not hold true in Mexico, for whatever reason. A new thrust of late has been to design programs to link the two parts of the economy and to invite foreign suppliers of Mexican firms to establish themselves in Mexico. This would have the added value of increasing domestic content, a prerequisite for complying with rules of origin established within the framework of existing free trade agreements with Europe and Asia.

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3. Serra, Jaime, *Apertura y Crecimiento en México*, May, 2012, PowerPoint presentation

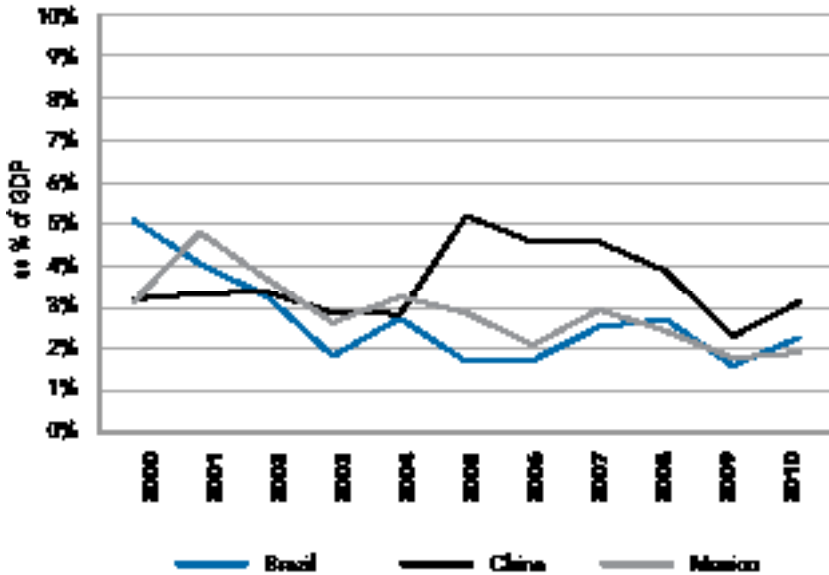
The concept of developing an industry of domestic suppliers continues to be valid, but not necessarily the way private-sector leaders propose. For such a concept to be successful, it would have to develop and be promoted under the rules that exist at present: that is, without protection, but with the express objective of raising the national content in order to generate more growth and more jobs. The path that most existing firms prefer would be to maintain protection for themselves, and to obtain subsidies for those wishing to become suppliers. However, that road has proven a failure. The evident implication is that the industrialists of the future will not be, in general terms, those of the past; instead, they will be those who invest in order to become hypercompetitive and to connect with the large exporters. Many of these will be domestic, many foreign.

### HOW TO GET THERE?

Investment is indispensable to growth and private investment has grown at below the equivalent rate for other nations over the past several years. Foreign investment, while growing, is much lower as a percentage of GDP than that targeting China or Brazil. Returning to the old debate about the direction the economic policy should take, many politicians and candidates continuously call for the adoption of an explicit “industrial policy”. The question is whether such an action would alter the existing scenario. Thanks to the reforms of the past few decades, today Mexico boasts a formidable export sector that competes successfully. This suggests that the issue is not the lack of an industrial policy, but the old, decrepit manufacturing sector. What keeps the economy depressed is the old productive plant that, thanks to a number of explicit or implicit protective mechanisms, remains uncompetitive. Those two, largely unconnected, industrial sectors are a key trait of the Mexican economy today: the next administration should address the need to connect them, probably by promoting the development of a supply industry for exporters.

The inevitable conclusion one reaches is that Mexico urgently needs to transform its traditional productive apparatus, both industry and services. In essence, what is most crucial is forcing these to compete by eliminat-

### Foreign Direct Investment



Source: CIDAC, with data from *The World Bank*

ing the protection mechanisms to which they are privy. These mechanisms include customs duties, investment limits, Mexican control requirements, and non-tariff barriers of all kinds that consequently impede plant modernization and force consumers to pay higher prices. These elements constitute extraordinary handicaps for producers who need to enhance their productivity levels in order to succeed in the marketplace. In fact, Mexico is ranked 54 of 179 in the Economic Freedom Index of The Heritage Foundation and *The Wall Street Journal*. This ranking takes into account variables such as property rights, corruption, fiscal, trade and investment freedom, etc. Within this index Chile ranks 7; Peru, 42; and Colombia, 45.<sup>4</sup>

The debate about how to advance the transformation of the Mexican economy lingers at different levels. A previous chapter explains the dynamic of reform and the complexity of the choices that the country faces in this

4. <http://www.libertad.org/wp-content/uploads/2012/01/Indice-2012-de-Libertad-Economica.pdf>

regard. What is clear is that Mexico must break away from many of the structures and regulations that remain from a different economic era. For example, while imports of goods were liberalized in the 1980s, services were not. The same is true of government-owned corporations, which enjoy a monopoly of the goods they manufacture. The reforms of the 80s forced the private sector to compete, but did not do the same for the government-owned corporations. They opened up importation of goods, which forced manufacturers to compete or die, but nothing similar happened with services, with what the energy monsters produce or with the government itself. These are key productivity challenges for the future. Now, fully engaged in the XXI Century, we must deal with the consequences of what was not done.

What we have is the collision of two worlds. On the one hand, the liberalization of the economy was and continues to be partial, leaving in its path infinite gaps of unproductiveness. On the other hand, there is a political system that was never reformed and that translates into plundering rather than of promotion by the authorities, at all levels of government. Some government offices and officials might promote investments; others are in the business of exploiting their presence for personal gain. In the old system, much of which persists, governmental and political positions were distributed with criteria of awards for loyalty to the system or to expand the realm of control. That is, naming public officials responded to a rationale of political control and quotas to the unions that were part of the political party (PRI) and entailed implicit permission to utilize each post for personal ends. Loyalty to the system was rewarded with positions that afforded access to power and/or corruption. A functionary saw the post not as an opportunity to generate economic development, attract companies to their locality or raise the productivity of an industry or a sector, but as a means of personal or group enrichment. The latter practice has not changed practically anywhere.

Although the economic transformation that the country has experienced over the past decades has exerted a lesser impact than that promised, in the last 25 years there have been numerous “investments,” assets that have been built and developed, that little by little have transformed the nature of the economy. The following are the most prominent: the liberalization of imports, which has drastically reduced the cost of industrial

goods, but also of meat, clothing and footwear, to cite some obvious examples. The growth of the physical infrastructure—highways, dams, bridges, generation of electrical power—has permitted raising the companies' productivity, reducing communications costs, and making the supplying of electrical power reliable. The export capacity of the country has mushroomed in volume and in geographic diversity. With all of its defects, the electoral system has transformed the political culture. The middle class has grown in prodigious fashion. Business productivity is comparable today with that of economies much wealthier than that of Mexico. The point is that, despite all of the limitations and problems, the country is transforming itself below the surface.

### IN CONCLUSION...

As the export sector attests, Mexico's economy has succeeded in increasing its level of competitiveness and its growth rates, although lower than what Mexicans would desire, have been improving relative to those of the rest of the world. However, two issues need addressing. One has to do with the existence of two, radically different, industrial sectors that have been described. The other factor that characterizes the country in general, and not just the economy, is the fact that the government, at its three levels, has not modernized. This has produced an exceptional circumstance: we have first-world enterprises but a fifth-world government.

Despite its shortcomings, the transformation of the Mexican economy is extraordinary. Of course, further advancement is necessary. In particular, the economy needs to undergo a productivity revolution. Mexico's economy is dysfunctional in many ways but, as Gordon Hanson argues (see chapter II), its problems stem less from lack of reform than from inconsistencies that the reforms have revealed. One way to advance would be to think about new ways to deepen industrial ties across the three borders of North America to enhance the competitiveness of the region as a whole. For the country to be able to do that, however, Mexico would first have to address the quality of its governing institutions at all three levels: federal, state and municipal.



The profile of the Mexican economy is very distinct from that of the U.S. To date, this has led to a division-of-labor schema among companies on both sides of the border, but has not entirely ushered in a strategy of regional competitiveness. To do an about-face from its own recession, the U.S. must raise its productivity and drastically increase its exports. Mexico can be the key for the U.S. to be successful in this transformation. As Luis de la Calle argues, “the rebalancing of the world economy and eventual deleveraging mean the U.S. will reduce its current account deficit. It is much better for everybody, but particularly for Canada and Mexico, that the adjustment takes place via increased exports rather than fewer imports. To achieve that, increasing exports of finished manufacturing goods at competitive prices implies co-producing them with Mexico”.<sup>5</sup> That would require both a re-vamping of the U.S. regulatory structure to make it possible to incorporate Mexican components into American exports, as well as for Mexico to, once and for all, attack the obstacles that today protect a huge part of the manufacturing base. In technical terms, there’s no beef. The question is whether we will have the capacity and, above all, the penchant for making it happen. True, competent and strong leadership could do wonders.

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5. *Nafta should look beyond its borders to the world*, Financial Times, April 16, 2012 10:17 pm

## AN ENERGETIC VICIOUS CIRCLE

Without a doubt, Mexico's energy sector functions poorly. It is costly, unproductive and inefficient, and requires not only enormous investments to deliver on its mandate, but also modern technology. Also, current trends in the world oil and gas markets suggest that further delays in exploiting the country's oil reserves may render them less valuable. No one can take issue with the need to reform and transform the sector.

Yet, the apparently "obvious" solution is not so obvious. Many people assume that PEMEX ought to be privatized or at least subjected to market discipline by placing its shares on the stock market, much as Petrobras has done. The idea is attractive and conceptually sound, but not necessarily possible.

Mexicans tend to be tied to their history and the 1938 Oil Expropriation was a major historical feat that shaped perceptions and strengthened the ideological foundations of the political regime. From this perspective, the property of the oil resources has become a stalwart of the country's nationalism, an untouchable sacred cow. The PRI regime exploited these facts shamelessly and built its legitimacy on both the property of the resources as well as on maintaining a distance from the United States. Even Mexican children's textbooks have served to strengthen this belief, and confer epic proportions upon it.

Beyond ideology and manipulation, Mexicans have suffered the consequences of poorly designed reforms and the privatization of some companies (this is especially true of the banks, which had to be rescued at an enormous cost); thus, they reject outright any notion of energy liberalizing or privatization. Needless to argue, every beneficiary of the status quo does nothing but strengthen these perceptions in order to preserve it.

In more practical terms, even assuming that both historical and ideological facts could be overcome, the notion that the company could be privatized or that it could be quoted on the markets is utterly absurd. The reason for the latter is that PEMEX is not a company.

PEMEX is a political entity, more a government ministry than a productive enterprise. It is organized to serve the interests of its stakeholders and beneficiaries and not of its theoretical shareholders (the people of Mexico). It has served as a source of "petty" cash for presidents since its inception and caters to its prime stakeholders: the government, the union, its bureaucracy and its contractors. It is not surprising that, given the alignment of interests among all of these, paralysis is the status-of-choice for all.

PEMEX needs to be transformed, but for that to be possible would require a clear-cut decision to move toward, first, turning it into a business enterprise. A long-term

vision would establish a series of steps that would inexorably entail extraordinary political battles because such a transformation would affect key internal interests. In other words, the only way to transform the entity would be to assume the enormous cost and time that such an enterprise would require and to allocate the resources—political and managerial—to achieve it.

Attaining the objective of turning PEMEX into a modern business enterprise is not unfathomable, but it would not be easy, inexpensive or even achievable in the short term. However, this will not happen unless the process starts today.

## VII. Security and Violence

Pictures coming from Mexico of decapitated bodies, massacres and hanging corpses have become common in the American media. Indeed, violence has dominated the Mexican scene for several years. Many associate this with drugs, others with the availability of weapons and most with corruption. While all of these play into the mix, they are mere symptoms; in fact, the truth is much simpler: Mexico has never had a professional and reliable police force and judiciary. Drugs and organized crime came to dislodge an old and politicized (albeit somewhat effective) security system, but are not the cause of the problem; they just make it obvious and magnify it. The obvious solution consists of building state capacity—law enforcement and judicial competence—but Mexico has been too slow in the past few years to advance in that direction. Once—and if—that is in place, Mexico will be in a position to adopt strategies that are similar to countries that face a drug problem but are not overwhelmed by it, such as the United States or Europe.

Mexico never had a professional police and judicial system. What it did have, throughout the greater part of the XX Century, was an authoritarian political system that controlled everything, including criminality. Instead of building a modern country, the PRI system constructed an authoritarian system that was equal to the challenges of its time and conferred upon the country the stability necessary for achieving economic growth and the consolidation of an incipient middle class. These were not lesser achievements when one compares the Mexico of the 40s and 50s with other nations, but neither did they constitute the formation of a modern country.

A comic strip of the 1960s, “Los Supermachos,” faithfully reflected this era. The police chief and the municipal president were plainspoken, guileless characters who resolved problems based on what life had doled out to them. No one could accuse them of lacking in creativity, but their skill derived from experience, not from training, technical proficiency or the existence of a professional apparatus. It was a coarse and primitive world. Thus, exactly thus, was the police and the judicial power. Not much has actually

But what is government itself, but the greatest of all reflections on human nature? If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself. A dependence on the people is, no doubt, the primary control on the government; but experience has taught mankind the necessity of auxiliary precautions.

—JAMES MADISON, FEDERALIST 51

changed... While problems were local and smaller, the state apparatus, in the broadest sense, was adequate and sufficient for dealing with them. As with “The Supermachos,” it wasn’t that there was a modern and sufficiently developed capacity, but rather one that was enough to keep peace in the country. It wasn’t a modern state, just one that functioned for what was minimally required.

The growth of the narco responded to a good extent to changes taking place in other latitudes: the structure of the U.S. market, the success of the Colombian government in regaining control of its country, and the closing of the drug-trafficking routes achieved by the Americans in the Caribbean. These three factors contributed to the concentration of narcos in Mexico and consolidation of the Mexican mafias in the business, and became an element of brutal transcendence throughout the nation. In addition, the U.S. southern border became more constricted after 9/11, making the situation more territorial and less strictly logistical.

The underlying point is that the Mexican government did not possess the tools or the capacities to respond to these challenges. All of a sudden, at the beginning of the 90s, the country began to experience deep changes in its security structure that sealed its fate: first, a primitive and incompetent security system, totally politicized; second, the erosion of traditional controls; and, finally, the plate filled to overflowing, the expeditious growth of criminal organizations with economic might, armament, and the disposition to engage these at any price.

## **SECURITY: FROM WHERE?**

The issue of security is multi-faceted. Conversations about security in Mexico today tend to mix the issue of personal safety—the risk of being assaulted, kidnapped or murdered—with the drugs that have become so prominent in the news and, in some regions of the country, the only relevant issue. However, these are not the same nor do they follow similar dynamics. The problem of public safety is not new and has never been faced, which has led it to mushroom. Although the dynamics of the drug business have nothing to do with the issues of crime and delinquency, failure

to address these problems made it much easier for drug trafficking to become the single biggest challenge to the government and to Mexicans as individuals. What does unite both issues at their core is the impunity that criminals of all sorts have enjoyed.

Security problems are endemic and very longstanding outside major urban centers. Rural areas historically have been extremely violent and insecure. Ancestral disputes about land and other similar underlying conflicts persist; in addition, religious quarrels create an environment of latent insecurity. Meanwhile, urban areas enjoyed years of relative security, largely due to effective management of crime, rather than a duly established security policy. Crime was contained thanks to the discipline exercised by the political system. Decentralization of power that began occurring in parallel to the weakening of the presidential system from the 1990s on was not matched by the development of local (state and municipal) security institutions, making it possible for crime to flourish. That was the environment into which the drug mafias came to settle.

The main difficulty in solving the problem of insecurity and violence affecting the country lies in the underlying theme that characterizes virtually all in the nation's public life: impunity. The impunity that Mexicans suffer is ubiquitous: it is found at the core of government corruption; in tax evasion; in the form of street vendors; in government and private monopolies; in policemen demanding bribes; in the private use of public goods; in the existence of criminals and thieves known to authorities that do nothing about them; in the existence of political forces that live outside the law (from the drug traffickers to the Zapatistas); in the way people park in the middle of the street; and in the endless demonstrations that Mexico city dwellers suffer daily. At the core of these symptoms lies impunity, which goes hand in hand with the absence of the rule of law.

## **CRIME AND DRUGS**

The crime wave Mexicans have experienced has two distinct origins. One has to do with the structure of security that has existed in the country, the other with the dynamics of the various types of organized crime.

Public safety was achieved, at least in large cities of the country, not through a professional police force but as part of the political structure itself. The PRI system addressed the issue of security the way it did everything else: with controls on the various leaders, both formal as well as informal. In just the same way the old, PRI-based political system maintained a structure of control over the labor, peasant and popular organizations through cooptation of leaders (using corruption and access to power as vehicles), it managed crime through controls on the criminals themselves. Although the police never developed a modern and professional force, it was effective both at controlling crime, as well as at investigating it. Prosecutors were not organized to solve complex crimes, but to administer justice from the perspective of power; the objective, as with all else in the old system, was political control.

With the end of the era of top-down controls, the nature of the country's police forces has turned against both government and the population. The disappearance of those mechanisms of control and the absence of institutions, training or discipline made it possible for the police forces to join or be corrupted by organized crime. People are afraid of the police because, in exercise of its authority and weapons, they tend to abuse the citizenship. In one word, the police ceased to be effective either for political control or to combat crime.

Most of the violence Mexico is experiencing is not government-generated, but the product of weak institutions in the presence of the onslaught of extremely powerful exogenous forces. In this context, societies adapt to their circumstances because they have no other choice. Violence, corruption and other social ills undermine development and provoke responses that are often inimical to the growth of the economy and the deepening of democratic forms of governance. As governments and societies attempt to respond to the challenges that criminality poses, the natural instinct is to reform existing institutions. Reforming is obviously needed at various levels, but the strategic emphasis and thrust of those reforms needs to be on strengthening the institutions of governance, for that is where the problem starts.



## GOVERNANCE IN PERSPECTIVE

Over the past two decades, crime and violence have come to dominate the lives of people in Mexico. Organized crime has taken over key activities and even entire industries; drug cartels have transformed the landscape; non-institutional actors have become key players in society; migration has increased in unprecedented numbers; and corruption has grown or further entrenched. The first task has to be to differentiate these issues and analyze potential correlations, if any, among them, but the symptom of both is weak institutions.

Weak institutions occur in two ways. One happens as a result of mere history; the society never succeeded in developing a strong social structure and competent, workable forms of governance. The other comes about when a state and the country's institutions are overwhelmed by the corrupting forces of crime, illegal activities or other potentially triggering factors. Although certainly there are exceptions, it would seem that there is a correlation (or at least not necessarily a contradiction) between these two: when a country's already existing institutions are strong enough, they can withstand the onslaught of illegal activities; vice versa, when those institutions are weak, they are often incapable of dealing with illegality, crime and the powers that lie behind them.

In Mexico, the results of democratization have been different from what might have been expected. First, dismantling the old order proved much easier than anybody anticipated; second, the rules changed and citizens enjoyed much wider freedoms than before; and, third, regardless of the specific institutional arrangement that sustained the political system, the old regime guaranteed stability and control. When those certainties vanished, no new institutional structure had been built to replace the old sources of stability with new and modern ones.

Mexico has experienced a dramatic transformation in both its governmental structures as well as in the nature of daily life. There is an inevitable (and well tested) correlation between the strength of the institutions of the society and the level of illegality and corruption in them. From this perspective, part of the reason why crime levels were much lower in the past has everything to do with the structure of authority and control that Mexico

developed. The end of that era surely explains part of the contrasting reality. Thus, Mexico went through a democratic transition but never experienced a regime change. To a large extent, the institutions of the old regime remain in place and, although many have become obsolete, there has been virtually no development of properly democratic and accountable institutions. The accidental, disorderly and unplanned process of dismantling the old regime has not been accompanied by a process of transformation. Hence, the country today is characterized by democratic practices and demands but not by a democratic structure. It is in this context that one needs to understand the rise of organized crime.

### THE RISE OF ORGANIZED CRIME

The first wave of organized crime, the trait of the 90s, was related mostly to theft, contraband and pirated goods. The second wave, which started in the late 90s, is mostly related to narcotics and, eventually, to other forms of violent crime, including extortion and kidnapping. Both are global in scale.

There are two types of explanations for the phenomenon of criminality: some are endogenous in nature because they arise from the national reality itself, unique and distinct as it is from that of the rest of the world. The other type of explanation also arises from the domestic reality, but is produced within an international context, which affords it its own characteristics. The two types of explanation are not contradictory, but they reveal distinct dimensions of the problem, each thus meriting its own analysis.

“Transition presupposes—says Joaquín Villalobos—dismounting repressive apparatuses, reconstructing institutions, learning to employ the laws, and protecting the citizen instead of keeping a watchful eye on him.”<sup>1</sup> The political transition opened a new space of freedom for the citizenry and of competition for political parties. In the process, it changed the structure of numerous institutions, modified power relations in society and among distinct levels of government, and created fissures in control mechanisms

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1. Villalobos, Joaquín, *México Mirándose al Ombligo*, Nexos, January, 2010

that previously were sufficient to restrain citizens from acting on their own. Unfortunately, this also facilitated the growth of organized crime.

According to Marcelo Bergman<sup>2</sup>, a cluster of factors coincided in several countries in Latin America in the 90S: the decentralization of power, the demand for consumer goods by the lower middle classes, the appearance of organized crime eager to satisfy this demand, and the appearance of China as a source of low-priced products that satisfied this market. In Bergman's perspective, the world changed in the 90s because fragmentation of power and the appearance of emerging middle classes (and pent-up demand for consumer goods) created conditions for the remaining two factors to concur and create a space of opportunity for criminality that had not existed for decades.

Although every country is distinct, various nations of the American subcontinent experienced profound changes in their political and governmental structures during the same period. In some cases, the change put an end to military dictatorships and instigated the beginning of civilian governments, while in others, the change was due to processes of democratization. In both cases, the core factor was the decentralization of power. This decentralization implied the transfer of former control mechanisms to other governmental levels, which, at least in legal terms, had always been responsible for public safety; that is, what was de facto in the hands of the central authority now passed to state and local authorities. Of course, the state governments did not assume that responsibility, which is the reason, or at least a major reason, why the security system collapsed so thoroughly. The problem is that these authorities were not organized or trained for what suddenly fell to them to carry out, and, in many cases, they did not possess the understanding of the challenge that was now theirs or the instruments to respond to it. Countries such as Chile and Uruguay, which have centralized (unitary, as Bergman calls them) systems of government, did not experience power decentralization and also did not find themselves in the midst of sudden rises in criminality.

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2. Bergman, Marcelo and Whitehead, Laurence, eds., *Criminality, Public Security, and the Challenge to Democracy in Latin America*, University of Notre Dame Press, Notre Dame, Indiana, 2009

The second component of the picture in Bergman's assessment is perhaps the most significant and original. The existence of a repressed, pent-up, demand for consumer goods by the incipient middle classes is not only a factor of economic, but also of social and political, transcendence because it demonstrates the improvement of these societies as well as the failure of statist economic policies of the previous decades that had handicapped development. The emerging middle classes observed the manner in which the upper middle classes consumed, but didn't have the economic capacity to acquire, the same goods. This source of demand was satisfied by organized crime.

The first wave of criminality materialized with car thefts. These very automobiles found their way to chop shops for sale as parts or for export to other markets in the same region. Over time, yet other markets prospered: bootleg CDs and DVDs, stolen consumer goods, and so forth. The major corollary of the process was the appearance of China as the supplier of inexpensive and attractive goods for an available market. Contraband followed on the heels of all this. With boundless celerity, Chinese goods inundated the clothes, shoes, electronics, computer, and toy markets in these nations. The consumer of these goods may not have had access to the most sophisticated sound or video devices or to the best-quality films, but he did have the same opportunity for diversion as the most pretentious consumer.

In their seminal article "Broken Windows," James Q. Wilson and George Kelling argued that when a building's broken windows are not repaired or replaced, the street vandal will soon break all the rest. The authors developed a theory of criminality with this metaphor, which postulated that when the most fundamental crime is not dealt with, it mushrooms until it becomes a phenomenon ubiquitous in its irrepressibility. What Bergman has observed in the previously mentioned countries conforms to this rationale: instead of attacking the problem when it began, countries whose structure of governance deteriorated or collapsed, and whose populations were too concerned with the great political themes of building a democracy, neglected the safety of their inhabitants. Heisting cars was followed by piracy, which was followed by an increase in drug trafficking, and then violence. Of course, drug trafficking had been taking place for decades; what changed was the concentration of the trade through Mexico and the Mexicans taking increasing control of the business away from the Colombians.

In contrast with “traditional” organized crime involved in smuggled, stolen and pirated goods, narcotrafficking, an equally global business, followed a different pattern. Mexico has always been a natural route for drugs coming from the south to the U.S. market. For decades, the Mexican route was one of many that included Central America, the Caribbean and Florida. The success of the American government in virtually sealing off Florida during the 1980s led to a concentration of the trade through Mexico. Also, as the Colombian government strengthened itself and succeeded in controlling its drug cartels, Mexicans took over the business and replaced the Colombians. This change entailed a dramatic shift: while the Colombians were essentially interested in the U.S. market and changed transportation patterns to advance their business—in other words, for them Mexico was merely a transit point (a logistical hub) in a long geographical chain and thus, had no territorial rationale in the country—the Mexican organizations had local roots and gradually established themselves as controlling organizations in their specific regions. A Sinaloa-based organization tended to concentrate its business in that state, while one from Veracruz did the same. What had previously been a largely logistics business suddenly acquired a territorial nature. The 9/11 attacks further added to this trend; a fortified border made it more difficult to use “informal” means to enter the U.S. through the association with corrupt border police and customs officers. Thus, the cartels began to establish themselves along the border to build tunnels and other, more permanent, means of access. These two shifts—from the Colombians to the Mexicans and 9/11—created a new reality: a stronger group of Mexican cartels with a much bigger business than the Colombians ever had through Mexico and a strong territorial foundation. The existing institutions of the Mexican government proved incapable of controlling this network.

As these organizations grew and imposed themselves in their own regions, they began to expand into other territories. The driver for this development seems to be twofold: on the one hand, to further expand control of routes to the U.S. (which has involved roads, major highway crossings and the border itself); and, on the other, to develop and expand the domestic market. Much of the violence that Mexico has experienced is related to this process. By the same token, many of the losers in these wars have moved into other areas of violent crime such as extortion and kidnapping.

## IMPACT OF ORGANIZED CRIME ON SOCIETY

Organized crime affects the civilian population in unpredictable ways. Criminal organizations use violence, or the threat of violence, as a means to subjugate the population and to exact compliance with their rules. Hence, crime statistics are only part of the picture. The more established and organized they are, the less violence there tends to be: criminal organizations are driven by their business and, as long as the population complies, they do not need to use violence as a deterrent. But the threat of violence and the mere presence of these organizations erode the trust of the population in the formal institutions of society and in government in general. Many people, both in the regions controlled by criminal organizations and among the elites who are not directly affected, often assume that no crime is being committed because this is no more than a business—illegal, but a business after all. Hence the frequent call to abandon any attempt to counter these organizations, to negotiate with them or to let them be.

The erosion of State capacity and the ever-larger presence and power of the criminal organizations—each happening for its own reasons—combine to produce *de facto* governing structures that impose their rules through formally established authorities. In some Mexican states and in weaker nations, such as some of the Central American countries, the cartels often decide who the authorities are or simply override them.

These factors cause permanent damage to a society. The imprint of fear on ordinary lives, and what this does to the fabric of society, has an impact on choices as simple as changing shopping habits to changing the nation's presidential politics. Though most Mexicans are not direct targets of criminal organizations or of violence itself, they have been forced to alter the way they dress, how they commute to work, how they travel, what they do in the evenings, and how they socialize. Over the past few years, 44 percent of citizens have stopped going out at night, 25 percent have stopped taking taxis, and 21 percent have stopped going out for dinner. Companies have seen their costs on security grow by more than 11 percent. In the federal government's budget, security expenditures in 2010 were six times those of 2005. Yet, most people are not worried about drug trafficking, but about kidnapping and extortion.

In a recent study titled “8 Crimes First,” researchers from the Center of Research for Development—CIDAC) developed a method to understand which crimes impact the perception of insecurity of the citizens and to what degree. According to their model, in a catalogue of 33 potential crimes at a given local jurisdiction, only eight negatively impact people’s perception of security. The study’s results indicate, for example, that abduction has twice the impact in society than murder related to organized crime. The impact a single abduction generates is so great that an increase of 10 abductions per 100,000 inhabitants increases the perception of insecurity by nearly 5 percent.

People, particularly the young, have found new ways to adapt. Twitter has become a perfect vehicle to communicate shootouts, military patrols, suspicious activity and people. Many have emigrated, and middle-class Mexican communities have grown along the border on the U.S. side.

Three issues are present here: the effect of violence on the people, the society and the economy; the government’s attempts to respond (whether by proposing reforms or by attempting to recover control through force); and the moving target that organized crime represents. Some of these issues relate to the basic functions of government in an administrative or bureaucratic sense, while others have to do with a political regime, meaning the matter of political participation and democratic governance.

People adjust and accommodate to their environment. As has been argued, they do so in various forms, the examples of the informal economy and using corruption to maintain their livelihood are but two obvious ways. The same is true for the use of private security firms, higher walls and other means of protection. The other side of the coin is that, as they distance themselves from a rule-bound world, citizens also abandon trust in the state institutions that should protect them. In turn, crime, violence and corruption can significantly complicate democratic transitions while they degrade the quality of the existing political institutions. People adapt because they have no choice, but also because adaption can be functional, or better than the alternative. There is wide evidence that as criminal gangs become the established rulers of a territory, people begin to transact with them and ultimately the gangs become part of the community.

As powerless as the federal government, but particularly the state and local, may appear, they have both powers and instruments that the people

do not. Typical governmental responses are two: attempts to reform existing regulations, laws or institutions, and the use of force to try to re-establish full control of their territory. Numerous attempts have been made to reform institutions such as the police and the judiciary over the past decade. Although there are some success stories, the obstacles to reform range from the legal to the institutional to the political. The case of Colombia is suggestive; being the paragon for many, Colombia's successes have had to do less with specific reforms than with a change in emphasis. Once the Colombian government understood that the issue was state capacity in a different political context, everything changed. Simply reforming an institution in a sea of lawlessness leads nowhere; reforming as part of a wide-ranging transformation of a political regime stands a better chance. Many of those that have failed have ended up proposing "mano dura," meaning repression, as a last resort to revert a rapidly deteriorating situation. Others, like Mexico's PRI in the past several years and the new Guatemalan government, hope to capitalize on their reputations from a repressive past to impose effective disciplines in a democratic context. Colombia proves that there are no middle courses: either a government transforms itself or it simply reverts to the past and/or remains powerless.

After years and years of violence, the risk is that violence becomes, together with informality, the "new normal." Such a "new normal" could entail insurmountable obstacles to a return to civility and effective governance. After all, the problem is not drugs or criminal organizations, but the weakness of the institutions that are supposed to prevent and control it.

The challenge is to overturn the "new normal" and reestablish the normal, the conventional normal, as both the objective and the reality.

## **DRUGS AND SECURITY**

Mexico's security problem is one of institutions. Yet, the debate, in Mexico and elsewhere, is often derailed by side arguments in favor of "magical" solutions such as the legalization of drugs. Unfortunately, what appears to be a perfect solution may be nothing more than a chimera. Despite Mexico's being the nation most brutalized by the international drug trade, the idea



of legalizing narcotics may be simply an irrelevance, both because it would have to be the U.S. the real market, that legalizes, and because legalization requires a strong government (police and judiciary) to enforce the rules.

Those who favor legalization say it would resolve all problems. With a legislative act, violence would vanish and a taxable, multi-billion dollar industry would be created in its place. But the problem is that theoretical discussion of legalization ignores Mexico's broader political and social problems. It also ignores the conditions required for legalization to function.

The discussion about legalization often includes some unrealistic thinking about the nature of the drug market. To begin with, the crucial market is not in Mexico but in the United States. For legalization to work, the U.S. also must legalize drugs. Actually, the U.S. would have to make the move first: it is the largest drug market and the ultimate source of all the money. The U.S. market is so big that it creates its own demand and drugs will flow into its territory through any possible route. If Mexico were to succeed in controlling the whole of its territory, drugs would simply find a different conduit—and would continue to flow.

A U.S. liberalization of its drug policies would come as a very great relief to Mexico. But Mexico's problems would not go away; drugs compound Mexico's problems, but they are not their cause.

The root problem for Mexico is not the existence of drugs but the absence of a properly-functioning and cohesive state. Before Mexico's drug-related violence mushroomed to its current levels, the main problem was not drugs, but rather organized crime (ranging from abduction to car theft and product piracy and extortion), which the government has been incapable of handling at all levels. Drug trafficking did nothing other than make the challenge much greater.

Mexico's problem is one of police and judicial incapability, which has brought the state to its knees. Mexico never had a professional police and judicial system. What it did have, throughout the greater part of the 20th century, was an authoritarian political system that controlled everything, including criminality. The Institutional Revolutionary Party (PRI), which ran the country from 1929–2000 (and won the 2012 presidential race), constructed an authoritarian system that was able to withstand the challenges

of its time and which brought stability, economic growth and an incipient middle class, which was battered by inflation and economic crisis. A series of economic reforms during the late 1980s and early 1990s created conditions for a better economic performance, but these were incompatible with the political structures inherent in the old PRI system. The question today is whether a new PRI president will be able to break away from the structures that made PRI incapable of running a modern country.

The point is that the government could not respond to these challenges. A primitive, incompetent security system had become completely politicized and was quickly overwhelmed. Traditional controls were eroded and criminal organizations—with enormous economic might, cutting-edge weaponry and the willingness to use both—took advantage.

Legalizing or “regulating” drugs would be a conceivable response in a country in which police and judicial structures are capable of establishing rules and making them stick. This is, in fact, Mexico’s true challenge. Until that happens, the idea of legalizing drugs will be nothing more than water-cooler conjecture. The fundamental problem in Mexico is not the presence of an illegal drug trade, but the absence of state capability. Insecurity and the violence are the consequence of this absence, not its cause.

## GETTING THERE

The issue is institutions and that is where Mexico, for all the current and historical reasons discussed here, has missed out. Building institutions requires two components: one has to do with budgets, organization, training, rules and the like. However, it is the second component that is the critical one; for institutions to develop, the political forces of the country have to agree to abide by the rules inherent to them. In contrast with the former that is largely “mechanical,” the latter is political in nature. As has been argued in chapter 4 (*The conundrum of Mexican politics*), the lack of such arrangement is what lies at the core of the country’s political ills, including the weakness of its institutions. In short, for the security issues to be resolved, Mexico has to complete its political transition, strengthen its institutional framework and modernize its system of government: a very tall order.

Over the past few years, and in the recent electoral contest, several models of police and judicial organization have been put forth. Some would strengthen the police and judicial capacity at the local level, others would create a strong national police force. Each of the proposed models reflects a different vision of politics and of reality. Some would choose to strengthen and centralize power to restore the ability to exert control; others advocate the opposite model: transfer powers and responsibility to the state and municipal governments. The point is building and consolidating state capacity, and that is where the efforts should concentrate.

Yet, there is no easy way to get to that point. In 2008, the Mexican Congress approved the most extensive reform to the criminal justice system in the history of the country. It was intended to transform the criminal system from its historical inquisitorial nature to an accusatory model in eight years. The idea behind the reform was, precisely, to strengthen the police and judicial capacity at the local and federal levels. Four years later, only three states have implemented the new criminal system. As issues of public safety worsen throughout the country, the institutions—new and old—that are supposed to uphold the rule of law are incapable of doing so. There are many reasons and diagnoses for why the reform has failed to advance, but the one thing that is certain is that to significantly and permanently reduce impunity, completing the implementation of the new criminal justice system is imperative.

Once that is accomplished, Mexico will find itself with a different kind of problem: stronger institutions do not mean a lesser drug issue. Though the Mexican drug market has been growing, it is hardly a fraction of that of the U.S. In fact, historically, Mexico has largely been a transit point for drugs moving south to north. In other words, demand drives the market and as long as American consumers demand drugs, the shipments will arrive at their destination in some fashion. Mexico's geographic location makes it an inevitable hub for drugs that Americans demand.

From this perspective, the notion of eradicating the drug market or eliminating the drug trafficking organizations is a legitimate objective, but an impossible one for Mexico to accomplish if the U.S. does not remove the demand for those drugs. The last several years have proven that Mexico has a fundamental law and order problem that stems from the weakness

of its institutions. Its first responsibility is to develop those institutions; without them, no security or prosecution is possible. But once that task is accomplished, Mexico would have to do what all serious, democratic and successful countries do but often do not acknowledge—the impossibility of eradicating the drug trade as long as there is such a powerful demand for those substances. The country must then proceed to establishing rules aimed at protecting the population, limiting the damage that drugs produce and eliminating the violence.

There is robust practical and academic experience on this front and Mexicans were able to observe it in action just as the presidential contest was getting underway. Early in 2011, two Immigration and Customs Enforcement (ICE) officials were assaulted on a highway on their way to the U.S. One was killed, the other injured. Less than 24 hours later, American law enforcement organizations in the U.S. had detained over 600 individuals from the gang that killed the ICE officers. The lesson for Mexicans was plain and simple: the U.S. de facto tolerates the drug market. The U.S. officials knew who those individuals were and where they lived. Implicitly, the U.S. has set rules and is capable of enforcing them. That clear-cut enforcement action demonstrates that the U.S. was able to enforce its rules because of the strength of its law-enforcement institutions. As Mexico strengthens its institutions, it will have to evolve into a similar mode, one that eradicates the violence, protects the people and enforces rules against trafficking.

It is not easy to arrive at this conclusion. The last several years have been critical for Mexico and for the Mexico-U.S. relationship. While drugs have been flowing through Mexico to the United States for decades, for the reasons previously argued, it is only in the last decade that drug trafficking organizations became so powerful and violent. Little by little, these groups took over significant sections of the country, mostly along the border and around major highways. President Calderon's decision to confront the criminal organizations by sending troops to the most critical spots was well received in the most affected communities, yet has been very strongly criticized by public opinion elsewhere in the country. The president was forceful and dedicated to the eradication of the drug trafficking organizations but was less so in building a police force capable of eventually replacing the army or in getting local governments to build their own law-enforcement

bodies. He was also weak on explaining and creating a narrative about his objectives and how the means matched the goals.

Although the objectives set forth by the government to combat crime have varied, the strategy has remained constant through the Calderon administration. Its proposal has been clear: take control of the regions that have ended up in the hands of the narcos and decimate the criminal cartels. In a certain sense, both proposals have advanced; however, the results are not praiseworthy. First, there have been unanticipated consequences and, second, the few victories that have been achieved are not sustainable. Among the most evident of the unanticipated consequences concerns fragmentation of the criminal bands; every time the head of a mob is liquidated, an internal power struggle ensues that often translates into a multiplication of bands. The strategy would make sense in a country with strong state or municipal authorities who could combat the cartels when they were broken up. In Mexico, where functional local government has not existed since Colonial days, cartel fragmentation has heightened the violence and eschewed the historical rules of not upsetting the population. In this regard, the initial success of some of the campaigns has morphed into an inferno for the population.

Along the way three myths about narcos, organized crime, and potential tactics for combating these have gained a foothold. First is the myth of prevention. It is obvious that, to prosper, a society requires mechanisms that prevent crime and criminality in general, as well as strategies oriented toward driving economic and social development. However, prevention makes sense and is viable only prior to the existence of the phenomenon: what is already taking place cannot be prevented. The State urgently needs to build its capacity to protect the safety of its citizens and, once that is achieved, to prevent future criminality.

The second myth is that of negotiation. The idea is that, instead of combating too powerful an enemy or one that is affecting the population systematically (e.g., in cases of extortion), the government would negotiate an armistice with the criminals and would pacify the specific region. Outlining this in the abstract sounds reasonable, above all for politicians whose function it is, or should be, to forge agreements, pacts, and arrangements among dissimilar parties. However, negotiation with criminals entertains evident

problems: with whom does one negotiate? What would be offered in exchange? How would the pact be made to work and enforced? How would failure to comply be sanctioned?

The third myth is that of legalization. As has been argued, the idea of legalizing drugs is a chic one and exceedingly attractive because it appears to indicate that the problem of violence can be dematerialized with the flourish of a signature on a presidential decision. Not by chance do so many nostalgic former presidents propose this very action. But, similar to the idea of negotiating, practical problems render legalization absurd: how would the drugs be distributed? Who would be responsible? How would compliance with the rules be enforced? The key lies in establishing rules that the government has the capacity to enforce.

Although with diametrically opposed implications, proposals such as those of negotiation or legalization are not viable in the Mexico of today. In order for them to function, either of the two strategies would require the presence of a strong government, one capable of establishing rules and having them obeyed. If one accepts that the current problem is the weakness of the State, then it would be impossible to exact compliance and enforce an agreement in the case of a negotiation; neither would it be possible to assure the proper functioning of the market in case of legalization. From this perspective, drugs in Mexico are already "legal" (in the sense that they circulate with no difficulty) because no authority controls or regulates them. A strong State like the Netherlands can entertain such a proposition; Mexico today cannot.

The same would be true in the hypothetical case of the U.S.'s legalizing drugs: the only thing that would change would be the financial status of the criminals, but the criminality besieging the population, such as abduction and extortion, would not be affected in the least. These problems reflect the absence of authority, the inexistence of the State as such, as well as mediocre and incompetent police forces, and a feather-weight and corrupt judicial power. The paradox is that, to be able to contemplate strategies such as legalization or negotiation, the Mexican State would have to be transformed and, if this were achieved, those strategies would become irrelevant because of being unnecessary. The essence of the topic is the government's capacity and authority and in this, President Calderón, with all of his catastrophic strategic errors, was not wrong.

Future strategy should have as its objective the strengthening of the State in order for it to impose the rules of the game, that is, to draw a line in the sand. The drug business, as distinguished from that of local criminality, would not disappear, but it would find itself head to head with a government capable of imposing the law forthwith. In this, the difference with the present government would be enormous. The objective would not be to eradicate narcos, but rather to force them to live in an environment controlled entirely by the State—just as the Americans do.<sup>3</sup>

The true challenge of the upcoming administration resides in strengthening the State without attempting to return to centralized control, but within the democratic context in which Mexicans live today. Decades of economic and political change have cast a very cynical population and a dysfunctional political system. What Mexico needs to complete its thwarted transition to a market economy and to a democratic polity is effective leadership. Paradoxically, only effective leadership—clear minded and learned—can deliver. Obviously, no rational citizenship would bet the house on a leader, but the evidence throughout the world is enormous and, often overpowering. As Felipe González or Nelson Mandela can attest, there is no case of successful transition in the world without effective leadership. The question is whether the nostalgic PRIistas are capable of putting together a structure such as this.

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3. Kleiman, Mark, *Surgical Strikes in the Drug War*, Foreign Affairs, September-October, 2011

## VIII. The Future

An old saying has it that Mexico has two possible solutions to its problems: the technical solution and the miraculous one. Honoring Mexicans' creativity—and black humor—the technical solution would entail praying to the Virgin of Guadalupe. The miracle would be for the people to get to work. If one looks back two or three decades, what is absolutely certain is that the country's problems are not insurmountable nor do they require religious solutions. In fact, many of the country's problems have been addressed and are being fixed. Although many of the reforms and actions have not produced all the desired results, today's Mexico bears no resemblance to that of past decades. All that is missing is the proper environment for people to be successful. The big question is how to achieve that.

Without a doubt Mexico faces enormous challenges. Historical inefficiencies have accumulated to produce extraordinary levels of delinquency and crime, as well as economic stagnation. These circumstances have generated widespread pessimism. It is equally clear that Mexico is not doomed to stagnation and underdevelopment: responses and solutions are within; all that is required is for Mexicans to take hold of them and make them their own. In this sense, the real challenge is to find a way to match capabilities with problems, and that is a political issue.

The central question that frames the country's dilemmas and challenges does not refer to drug trafficking or oil, or this or that economic or political reform. The issue is how society will muster its forces and resources to meet the needs and demands of a population eager to solve basic problems without the tools to do so. The priority should be to generate wealth and this can only be achieved in a context of freedom with all its complications, because the alternative of imposition has proved a failure. The question Mexico faces is one of leadership. Will Enrique Peña-Nieto be able to forge a coalition capable of breaking away from historical myths, special interests and legislative deadlock?

For many decades, the country has been characterized by an interminable series of vicious cycles on fundamental issues and fronts, but above all in



Constant development is the law of life, and a man who always tries to maintain his dogmas in order to appear consistent drives himself into a false position.

—GANDHI

the realms of the economy, the political process and security. Many reforms have been carried out in recent decades, many of which have had positive effects, but the result as a whole is clearly unacceptable. There are many reasons for the poor and often contradictory results, but the fact is that the overall picture is one of conformity and mediocrity. Inertia has taken over national public life, the perfect state for special interests to thrive.

The recent presidential contest is suggestive of the problem: a vast and ongoing debate about what to do and how to respond to these challenges without a single concrete proposal. What everybody agrees on is that maintaining the status quo is no solution. The problems are not new. As was argued before, the issue of economic growth has been at the core of the political agenda for more than four decades. The issue of political reform goes back to 1978 and the problems of security, which became paramount in the past few years, have been hunting the citizenship for 20 years. Despite this, there are few innovative proposals and most concentrate on different ways to restore the old system, recreate what worked in the 1950s and 1960s.

Mexico's true option lies in a very simple choice: persevere on the path of mediocrity that was inherited from the old PRI system—which is not viable in the era of knowledge where what counts is the creativity of the people—or start building a new development framework that begins with the recognition of citizens as the centerpiece of development and the government as a key factor in creating the conditions for this development to happen. This is the stark choice the new government has before it.

Mexico's stalemate is easy to describe. First and foremost, although the country embarked on a process of gradual political reform, the defeat of the PRI in 2000, which many saw as the critical piece in the process, brought alternation of parties in government but not a democratic structure of governance with proper checks and balances as well as accountability. Second, the process did not include the rule of law as the centerpiece of relationships among the citizens and among the politicians. Despite having developed an exceptional and impeccable electoral system, twice in the last decade a major presidential candidate has refused to abide by the result. And third, there has been inconsistent (and incompetent) leadership to advance the process. Unfortunately, Mexico did not have a Mandela or a Felipe Gonzalez to transform not only the reality but also the psyche of

the Mexicans. The difference with Lula's Brazil or Mandela's South Africa lies not in that their economies are that much better than Mexico's, but that their people imagine something better and that is the product not of chance, but of exceptional leadership.

The fundamental task of any government is to create conditions that make it possible for development to occur. However, up to now, Mexico's governments have been paralyzed by special interests that have impeded changes in education, competition, accountability and the rule of law. Regulations tend to favor monopolies, education is dominated by a union that rules over the teachers and the government, at all levels, caters to its own bureaucracies rather than to the citizenship. Mexico needs effective leadership of the sort that Peña-Nieto has offered in his rhetoric. However, it also needs good government and the two do not always coincide. If one trait characterized most PRI governments in the 20<sup>th</sup> Century it was precisely this contradiction: competent political operators and a lousy quality of governance.

As Macario Schettino puts it "there is only one way to defeat poverty and that is to equip all Mexicans with the skills and abilities to produce wealth. Although it may sound like a truism, this is precisely what we don't do."<sup>1</sup> The structure and strategy of the old PRI regime was to cultivate government-dependent citizens in order to maintain political control. Proceeds from oil exports were used to finance this dependence, nurturing various forms and instruments of political control, including the educational system.

Thoughts about how to overturn the status quo often end up with proposals for reform that do not solve the problems but nonetheless have the effect of raising expectations to untenable levels. Many of the proposed economic reforms do not address the relevant problems. The same is true in the political arena: most reform proposals are not designed to give access to citizenship but to redistribute power among those who are already powerful and in control of key levers of power or wealth. There is a direct link between democracy and markets but, as Carlos Heredia argues, "In Mexico we have something, but not a free market."<sup>2</sup> The country is stuck between the remains of the old political system and a protected industrial sector

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1. Schettino, Macario, *Nuestro Problema*, El Universal, México July 24, 2009

2. Heredia, Carlos, *Conference at Comexi*, August 26, 2008

next to a highly modern, productive and successful forward-looking export sector oriented toward the global economy. This cohabitation has not been a happy one and the government has been incapable of creating a competitive environment where all companies, as well as citizens and their organizations, have a reasonable chance of success.

Mexico's true challenge dwells in stopping contesting the past and moving on to the future. An improved economic outlook would help move the country away from endless ideological bickering and, as Einstein would have it, once one starts riding a bicycle, "to keep your balance you must keep moving". The key to the future lies in breaking the inertia and creating a momentum. The recipe for success lies not in specific changes, but in creating conditions that make it not only possible, but inevitable. All successful nations share three common denominators: effective leadership within proper counterweights, clarity of purpose, and continuity. A new administration is always an opportunity to break away from both the real and the mental hindrances to change. Peña-Nieto has before him a huge challenge, but also an immense opportunity.



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