

WebMemo



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Growing Instability in Mexico Threatens U.S. Economy and Border Security

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America's southern neighbor is facing trouble on several fronts:

- **Drug-Related Violence.** Drug-related crime and rampant violence have battered Mexico's sense of public security and confidence in the government's capacity to protect the lives of its citizens. Violence against Mexican law enforcement and military officials, as well as the corruption perpetrated by the drug cartels, is undermining public confidence in government institutions. Furthermore, the physical and psychological costs of the fight against the cartels are impacting trade, the investment climate, and the security of the U.S.–Mexico border.
- **Corruption.** Corruption in Mexico's public and private sectors is endemic. Mexico's score in the 2009 *Index of Economic Freedom*, published by The Heritage Foundation and *The Wall Street Journal*, declined from its 2008 score—a decrease aggravated by the country's low “Freedom from Corruption” rating.¹ Although Mexican President Calderon has been leading a courageous fight against it, according to Transparency International's *Corruption Perceptions Index for 2007*, “Mexico ranks 72nd out of 179 countries... [and] corruption has been pervasive for many years.”²

General Barry R. McCaffrey, former commander of the U.S. Southern Command and President Clinton's drug czar, recently reported that Mexico's powerful drug gangs have “subverted state and municipal authorities and present a mortal

threat to the rule of law across Mexico.”³ General McCaffrey warns that the spillover effect from the drug violence reaches far into both countries: “The malignancy of drug criminality now contaminates not only the 2,000 miles of cross-border U.S. communities but stretches throughout the United States in more than 295 U.S. cities.”⁴

- **Economic Woes.** In addition to the drug violence and corruption, Mexico is also suffering from economic turbulence. For instance, remittances sent home by Mexican emigrants in the U.S., which are “Mexico's second-largest source of foreign income after oil, [sank] 3.6 percent to \$25 billion in 2008 compared to \$26 billion for the previous year...and central bank official Jesus Cervantes said the decline will likely continue this year.”⁵

Furthermore, Mexico's large and important automotive sector has been slammed by the same economic woes facing Detroit.⁶ Mexico's economy is now forecast to shrink by as much as 1.8 percent in 2009.⁷ And the peso has weakened 32 percent against the dollar over the past six months—the second-worst performance among the world's major currencies after Brazil's real—on concern

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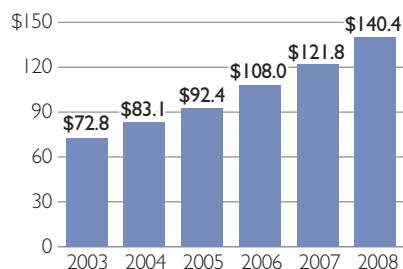
Mexico's Expenditures and Key Sources of Revenue

Figures are in billions of U.S. dollars.

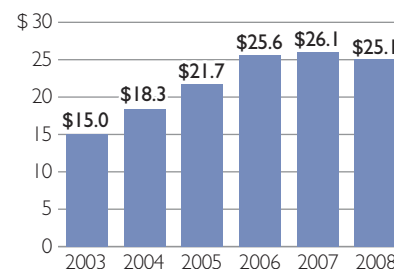
Total Expenditures



Oil Revenue



Remittances



Sources: The International Monetary Fund, "Mexico: 2007 Article IV Consultation—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion for Mexico," IMF Country Report, No. 1/379 (December 2007), p. 10, at <http://www.banxico.org.mx/documents/%7B3979ef0a-94b2-51e4-2b79-90966f7da611%7D.pdf> (February 10, 2009); U.S. Central Intelligence Agency, "Mexico," World Factbook, (2004-2008), at <https://www.cia.gov/library/publications/download> (February 11, 2009); U.S. Central Intelligence Agency, "Mexico," 2009 World Factbook, February 10, 2009, at <https://www.cia.gov/library/publications/the-world-factbook/geos/mx.html> (February 11, 2009).

Chart 1 • WM 2290 heritage.org

the economy will sink into recession as demand in the U.S. falters for Mexican exports.⁸

Consequently, the Central Bank has been forced to intervene in an "extraordinary" way to prop up the peso.⁹

Adding to the economic gloom, Mexican government revenues (more than one-third of which

come from PEMEX, the state-owned monopoly oil company¹⁰) are declining steadily. This revenue drop is the result of lower oil prices and declining output due to longstanding PEMEX mismanagement and inefficiency. Major political and economic reforms are needed now,¹¹ yet recent economic turmoil has made the political price of such reforms considerably higher.

1. The Heritage Foundation and *The Wall Street Journal*, "2009 Index of Economic Freedom: Mexico," at <http://www.heritage.org/index/Country/Mexico>.
2. *Ibid.*
3. Adam Thomson, "Mexico Rebuffs 'Failed State' Claims," *Financial Times*, January 18, 2009, at <http://www.ft.com/cms/s/0/1146c7c4-e58e-11dd-afe4-0000779fd2ac.html> (February 12, 2009).
4. General Barry R. McCaffrey (Retired), "After Action Report: Mexico Visit 5–7 December 2008," memorandum for Colonel Michael Meese, December 29, 2008, at http://www.mccaffreyassociates.com/pdfs/Mexico_AAR_-_December_2008.pdf (February 4, 2009).
5. Julie Watson, "Yearly Mexican Remittances Drop for 1st time," Associated Press, January 27, 2009, at http://news.yahoo.com/s/ap/20090127/ap_on_re_la_am_ca/lt_mexico_remittances (February 12, 2009).
6. Michael O'Boyle, "Mexican Economy in the Balance of Carmakers Rescue," December 4, 2008, at <http://www.iht.com/articles/reuters/2008/12/04/europe/OUKWD-UK-AUTOS-MEXICO.php> (February 6, 2009).
7. Associated Press, "Mexico's Central Bank: Negative Growth in 2009," *International Herald Tribune*, January 27, 2009, at <http://www.iht.com/articles/ap/2009/01/27/business/LT-Mexico-Economy.php> (February 6, 2009).
8. *Ibid.*
9. Valerie Rota and Hugh Collins, "Mexico's Central Bank Intervenes to Halt Peso Slide (Update4)," Bloomberg News, February 4, 2009, at <http://www.bloomberg.com/apps/news?pid=20601087&sid=aa.nNZl7rf7g&refer=home> (February 6, 2009).
10. Jesse Bogan, Kerry A. Dolan, Christopher Helman, and Nathan Vardi, "The Next Disaster," *Forbes*, December 22, 2008, at <http://www.forbes.com/forbes/2008/1222/073.html> (February 12, 2009).

All of these developments are severely impacting the price Mexican businesses and governments must pay to borrow money. Unfortunately, current ratings of Mexican debt and the attendant risk premiums probably do not fully reflect Mexico's dire straits. Potential foreign investors should beware.

A Vital American Interest. Mexico's ongoing political stability and economic health are critical to the prosperity and national security of the United States. The Obama Administration must make confronting the many challenges facing our southern neighbor both a foreign and a domestic policy priority. In order to realize this vital American interest, the current Administration should do the following:

- Not delay in sending an early and loud signal that it is prepared to work closely with Mexico and the Calderon government to defeat the drug cartels and strengthen—to the extent possible—Mexico's critical legal, law enforcement, and judicial institutions through an expanded and better funded "Merida Initiative" cooperation program. General McCaffrey warns that "Mexico is on the edge of the abyss—it could become a narco-state in the coming decade."¹² Inaction and indifference are not options.
- Pledge a renewed commitment to reducing the flow of illegally trafficked guns, bulk cash, and precursor chemicals from the U.S. into Mexico. Together, the U.S. and Mexico should reach out to Colombia and Central America to strengthen international cooperation critical to bursting the narcotics balloon.
- Recognize that Mexico's economic health is critical to the U.S. Consequently, both countries should reaffirm their commitment to NAFTA, and President Obama should urge President Calderon to continue efforts to reform Mexico's economy by breaking up monopolies and other oligopolies and to look for ways to assist with the agricultural and commercial development of rural and southern Mexico.
- Encourage Mexico to open its oil and electrical energy sectors to investment opportunities by U.S. companies. This should be another high priority goal for the Obama Administration, one that can have a stimulus effect on both sides of the border.
- Recognize that anyone—Mexican or otherwise—who enters, remains in, and works in the United States illegally is in ongoing and extensive violation of U.S. law. This has a corrosive effect on civil society and undermines confidence in the immigration process and the rule-of-law principles that govern the nation. Consequently, Obama should commit to a balanced and well-constructed temporary worker program that diminishes incentives for illegal immigration.
- Demonstrate that a change in Administrations will not lessen the United States' commitment to building better border security by enlisting the Mexican government as a stakeholder and responsible partner in a comprehensive strategy for controlling the border against all forms of illicit activity, from illegal migration to drugs and terrorism.
- Advance with the Mexican government a shared, vibrant, and productive relationship of commerce, investment, and properly regulated movements of people between sovereign nations. In pursuing this relationship, however, the Obama Administration must make clear that the U.S. seeks neither a North America union nor political integration.

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11. For more on reforms needed in Mexico, see James M. Roberts and Isabel Ortega, "How Reforms in Mexico Could Make the U.S. More Secure," Heritage Foundation *Backgrounder* No. 2135, May 13, 2008, at <http://www.heritage.org/Research/LatinAmerica/bg2135.cfm>.

12. Thomson, "Mexico Rebuffs 'Failed State' Claims."