PACIFIC COUNCIL ON INTERNATIONAL POLICY

The western partner of the Council on Foreign Relations

MEXICO

Transforming

MISSION STATEMENT:

The Pacific Council on International Policy aims to promote better understanding and more effective action, by private and public sector leaders alike, in addressing a rapidly changing world. It brings together leaders from diverse communities across the Western United States and around the Pacific Rim. Its focus is the interaction of global trends and local effects as national borders become more porous, traditional concepts of "public" and "private" blur and what constitutes "policy" itself is changing.

Pacific Council on International Policy
Los Angeles, CA 90089-0035
Tel: (213) 740-4296
Fax: (213) 740-9498/9993
E-Mail: pcip@usc.edu

Cover Photo by: Graciela Iturbide

CONTENTS

SUMMARY

The Mexicos in the minds of many Americans do not exist. Those who think of Mexico as unremittingly poor, rural, traditional and authoritarian have not kept up with the vast changes reshaping the country. Yet those who conceive of Mexico as already transformed into a modern, open, prosperous, stable and democratic nation overlook the immense problems the country is still very far from having resolved.

Mexico today is seeking to become less authoritarian, less presidential, less centralized and more open to the world, all at once. The transformations are uneven across different sectors and regions, and paradoxes abound. The presidency still can dominate the political system when it chooses, and Mexico City still is the paramount force in the country. Mexico is less authoritarian, but the army is being employed in more and more places to combat drugs and sustain order when local authorities cannot. Nationalist fervor, especially in parts of the south, impels politicians to reject more open economics, for instance in the energy sector.

Mexico today is many Mexicos. It is a country of deep divisions, particularly that between North and South, of which the conflict in Chiapas is a symbol. Some states in Mexico's rapidly democratizing North today enjoy per capita incomes similar to those of South Korea or Taiwan, but most southern states are at the level of Guatemala or Honduras. Indeed, the gap between Mexico's North and South is about as great as that between the United States and Mexico as a whole.

Few countries have undertaken more significant changes than Mexico in the past twenty years — market-oriented economic reforms and a gradual but accelerating process of political opening. But despite these welcome transformations, Mexico's troubles will compound if the country does not more successfully confront its deep social problems, including lawlessness and insecurity, grinding poverty, gross inequities, pervasive corruption and the lack of accountability. On some of these dimensions, Mexico's recent performance has deteriorated.

The Economic Transformation Is Striking But Uneven

Mexico's economy was protected and inward-looking, built around a strong state role in production and distribution, but it is becoming more open and internationally-oriented, with a more streamlined state. The "peso crisis" of 1994-95 was a devastating blow that revealed the underlying weaknesses of the country's prior political and economic strategy.

Now, as the North American Free Trade Agreement (NAFTA) nears its seventh year, direct foreign investment is booming, and integration has stimulated powerful forces of change in trade, investment, the environment, labor practices, finance and corporate governance. Since 1993, Mexican exports have more than doubled, and manufactured goods make up close to 90 percent of the country's sales abroad.

Yet structural reform is uneven, and integration has reinforced the existence of a two-tiered business class; fifty top companies, most of them maquiladoras and multinational enterprises, account for one-half of Mexican exports. The bail-out of Mexico's banking system is projected to cost $100 billion in public resources. Mexico continues to run a chronic current account deficit — about 3.5 percent of GDP. Perhaps surprisingly in a country long deeply ambivalent about its neighbor to the north, a debate has begun over whether to "dollarize" — that is, tie the peso irrevocably to the dollar.

More Plural and Democratic Governance But at Different Speeds

Mexico's political system was deeply authoritarian and highly centralized but is being reshaped as power and governance devolve. The turbulent presidential elections of 1988 sparked the rise of independent civic organizations, which began to erode the monopoly of the governing party, the Revolutionary Institutional Party, PRI. In the past the Mexican media often was on the public payroll. Now, the media's financial independence has inaugurated a new era of critical journalism.

Change has come most quickly in the realm of federal elections where the Federal Electoral Institute (IFE), once part of a PRI-controlled bureaucracy, is now independent. For the first time since the PRI's inception in 1929, the parties compete on a level playing field. The PRI retains control of the upper house, but the two major opposition parties currently command a majority in the lower house. Mexico now has clean elections but not yet clean politics; questionable money still flows into campaigns, and some state and local elections still touch off violent disputes.

The political system was built around an all-powerful president, but the current incumbent, Ernesto Zedillo, has inaugurated a less interventionist style. The change could be reversed in part by his successors, given the broad range of presidential discretion enshrined in the Constitution. Now, however, traditional PRI bosses in states such as Tabasco, Yucatán and Puebla have taken the refashioned presidency as weakness and strengthened their personal fiefdoms. Today, the PRI is more divided and less disciplined.

Despite the PRI's travails, it still remains the front-runner for the next presidential elections, in 2000. It is the only party with a truly national presence. It will win unless it splits or the main opposition parties — the National Action Party (PAN) on the center-right and the Revolutionary Democratic Party (PRD) on the left — can overcome ideological differences and personal egos to unite the opposition vote behind a single candidate.

Precarious, Limited Rule of Law

Mexico's transitions have cast a glaring light on judicial patterns inherited from the colonial past that seemed to serve tolerably well during Mexico's authoritarian, inward-looking one-party rule but are grossly deficient now: when direction from the center has less legitimacy, when crime is exploding and corruption is much more exposed, and when foreign and domestic investors require equitable, fair and transparent processes. A wave of criminality is sweeping through the country's major cities. A report by the Interior Ministry estimated that by 1995 there were about 900 armed criminal bands in the country, of which more than half were made up of current or former law enforcement agents. In poll after poll, Mexicans rank public insecurity as one their most important concerns.

As much as 70 percent of the South American cocaine bound for the United States market enters through Mexico. As Mexico seeks to contain drug trafficking, the Mexican military has become the supreme — and in some cases virtually the only — authority in parts of Oaxaca, Sinaloa, Jalisco, and Guerrero. Mexico's armed forces, unlike those in most other Latin American countries, have remained out of politics since post-revolutionary times. Now, however, in combating drugs and crime, they are being thrust into the limelight, straining traditions of unity and loyalty.

Managing the U.S. Connections

Internationally, Mexico has jealously preserved its sovereignty and independence from the United States, but powerful sectors of Mexican society now embrace North American and global integration. The plain lesson of the financial problems of 1994-95 and 1997-98 is that Mexico is directly linked to the fate of the U.S. economy far more than to the "global" economy. Mexico is unique among emerging market countries, for as it opens to the world, it is also becoming more affected by and dependent on what happens in the United States.

For both countries, the other is now virtually a domestic issue. For both, interdependence, however asymmetric — Mexico's GNP is but a twentieth that of the United States — is a fact if not always a fully welcome one. That fact presents challenges to both countries: how to make the most of economic integration and how to cope with social issues on both sides of the border.

At the turn of the millenium, Mexico has competitive political parties, increasingly fair elections, independent media and public opinion, vibrant civic institutions, separation of powers and countervailing authority by different branches of government, considerable devolution of public authority, market-responsive and internationally competitive industries, strong pressures to respond to major regional and ethnic inequities, and broad acceptance of its fruitful integration with the United States. Taken together, these changes represent profound transformation.

But if Mexico's past patterns have been shattered, the shape of the new Mexico is not yet determined. The central questions are whether and how Mexico will reshape its laws, institutions and practices to meet the challenges of an open international economy, of the technological revolution and of democratic politics.

PREFACE

In this time of global transformation, few countries have undertaken more significant changes than Mexico. Beginning during the administration of President Miguel de la Madrid (1982-1988), accelerating during the presidency of Carlos Salinas de Gortari (1988-1994), and continuing through the term of the current incumbent, Ernesto Zedillo, Mexico has undertaken bold economic reforms. It has substantially restructured and liberalized the economy, privatized previously state-run enterprises, and opened the country to foreign competition and investment. Mexico's call under Salinas for a North American Free Trade Agreement (NAFTA) and the successful negotiation to conclude NAFTA marked a sea-change in Mexican history.

Mexico's political changes have been almost as notable. For more than fifty years after Mexico's revolutionary turmoil, a single party, the Partido Revolucionario Institucional (PRI), ruled virtually unchallenged. That one-party dominance began to fray in the 1980s, culminating in the disputed presidential elections of l988, when even the official and suspect government tally showed Salinas barely garnering a majority. This episode was followed during the 1990s by political assassinations, continuing flagrant corruption, guerrilla violence, and growing skepticism of the ruling authorities.

A gradual process of political opening led to the 1997 congressional and municipal elections in which the PRI lost control of the legislature for the first time, and opposition leader Cuauhtemoc Cárdenas became the first elected mayor of Mexico City since the 1920s. President Zedillo has carried forward political reforms, working to make elections more transparent and opening up the system by which the PRI's presidential candidate is selected. For the first time in many decades, Mexico's political direction is unpredictable: no one today can be entirely certain who or which party will win the presidential elections in July 2000.

These changes are important, and yet Mexico's medium- and long-term prospects are by no means clear. It is possible that Mexico has by now turned the corner toward sustainable economic growth and self-reinforcing democratic political opening, but the country still faces enormous challenges. The process of political liberalization may well slow down, and could even be reversed. Political uncertainties, in turn, could severely retard the country's economic reforms. Both political and economic problems will compound if Mexico is not much more successful than it has been thus far in confronting such tough problems as lawlessness and personal insecurity, poverty, gross inequities, pervasive corruption, and the lack of accountability. On some of these crucial dimensions, disturbingly, Mexico's recent performance has deteriorated.

For California and other western states, no other country has a more direct impact than Mexico, so closely linked to this region of the United States. Western businesses, unions, schools and other institutions all stand to benefit from a better-informed and more refined understanding of Mexico's dynamics and prospects. It is equally in Mexico's interest for U.S. understanding of Mexico to improve and so avoid the sudden swings in American opinion and policy that can result from fragmentary impressions, exacerbated by economic swings.

As an international leadership forum focussing primarily on the international trends most salient to those residing in the western region of the United States, the Pacific Council organized a project during 1998-99 to analyze how and why Mexico is changing. We aimed to examine Mexico's transitions and to look beyond daily ups and downs and even past the 2000 elections, which will undoubtedly be important but will not necessarily be decisive in shaping Mexico's future. We chose, therefore, to focus on the drivers of that future — first, the country's impressive economic transition and the deep divisions that yet vex it, for which the simmering conflict in Chiapas is both an example and a symbol; second, the new actors and new roles for existing ones that are emerging; third, Mexico's unfinished political transitions; and, fourth, its struggle to build a rule of law.

The focus of the report is Mexico's future, not the bilateral relationship with the United States. Yet not only is Mexico more and more important to the United States, the review of the underlying drivers, at home and abroad, of Mexico's future makes plain just how large the United States figures in that future. Indeed, Mexico is in unique circumstances. It is globalizing but also becoming more dependent on and more affected by what happens in the United States. Thus, the report concludes by outlining three main challenges the two countries, together, confront.

To undertake this project, the Pacific Council organized a binational Study Group, bringing together persons of different professions, regions, generations and political backgrounds, both from the western United States and from Mexico. We succeeded in engaging a truly diverse group, unlikely to come together under other auspices, that worked together to explore Mexico's current situation and future prospects. Our Study Group met seven times — four times in California and three in Mexico — to discuss commissioned memoranda, to hear testimony from sectoral experts and prominent leaders, and to exchange information and ideas.

This report takes our collegial process a step further, drawing mainly upon the Study Group's rich and sometimes contentious discussions. It covers most of the topics we discussed and draws amply on our exchanges, but obviously does not and indeed cannot reflect all the diverse and often contradictory views we considered, nor all the points made in our discussions.

No member of the Study Group, listed at the beginning of this report, necessarily agrees with every statement in this text, and some take issue with specific points or lament omissions they consider significant. All listed members of the Study Group do agree, however, that this report draws faithfully upon the Group's deliberations and that it comprises a thoughtful and balanced assessment of Mexico's future, based upon our shared inquiry. Except as noted by the specific individual reservations published at the back of this document, all participants affirm that the report is an illuminating and constructive contribution, and all subscribe in general terms to its main findings.

Vilma Martinez
Study Group Chair

STUDY GROUP MEMBERS

Amb. Cresencio Arcos
Regional Vice President
International Public Affairs
AT&T

Mr. Alan Bersin
Superintendent
San Diego Unified School District

Amb. Paul H. Boeker
President
Institute of the Americas

Dr. Katrina Burgess
Professor
Department of Political Science
Syracuse University

Dr. J. Alexander Caldwell
Sr. Vice President & Mexico Regional Manager
EFG Capital International

Sr. Ernesto Canales Santos
Attorney
Oficina de Asesoría Jurídica, Monterrey

Dr. Wayne A. Cornelius
Director of Studies and Programs
Center for U.S.-Mexican Studies
University of California, San Diego

Dr. Rodolfo O. de la Garza
Mike Hogg Professor of Community Affairs &
Vice President, Tomás Rivera Policy Institute
University of Texas, Austin

Dr. Patrick Del Duca
Partner
Kelley, Drye & Waren, LLP

Mr. Frank del Olmo
Associate Editor
The Los Angeles Times

Dr. Denise Dresser
Professor of Political Science
Instituto Tecnológico Autónomo de México
Visiting Fellow, Pacific Council on International Policy

Dr. Carlos Elizondo Mayer-Serra
Director General
Centro de Investigación y Docencia Económicas, A.C.

Sr. Juan Enríquez Cabot
Researcher
David Rockefeller Center
Harvard University

Dr. Richard E. Feinberg
Professor & Director
APEC Study Center
IPRS/University of California, San Diego

Dr. Rafael Fernández de Castro
Dean, Department of International Relations
Instituto Tecnológico Autónomo de México

Ing. Carlos Fernández González
CEO
Grupo Modelo

Ms. Rossana Fuentes-Berain
Journalist/Teacher

Mr. Nathan Gardels
Editor
Global Viewpoint
New Perspectives Quarterly

Amb. John Gavin
President
Gamma Holdings Incorporated

Mr. James O. Goldsborough
Foreign Affairs Columnist
San Diego Tribune

Mr. J. Ernesto Grijalva
Vice President, Latin America Legal Affairs
PriceSmart, Inc.

Ms. Antonia Hernandez
President and General Counsel
Mexican American Legal Defense and Educational Fund

Mr. Timothy Heyman
President
Heyman y Asociados, S.C.

Dr. Raul Hinojosa-Ojeda
Research Director
North American Integration & Development Center
University of California, Los Angeles

Mr. David Huebner
Managing Partner
Coudert Brothers

Dr. Miguel Jáuregui
Attorney
Jáuregui, Navarrete, Nader y Rojas

Mr. Robert W. Lovelace
Executive Vice President
Capital Research Management Company

Dr. Abraham F. Lowenthal
President
Pacific Council on International Policy

Ms. Monica C. Lozano
Associate Publisher and Executive Editor
La Opinión

Sr. Gaston Luken Aguilar
Chairman
GE Capital, Mexico

Dr. David W. Lyon
President and CEO
Public Policy Institute of California

Mr. Richard Mallery
Partner
Snell & Wilmer

Ms. Vilma S. Martinez
Study Group Chair
Partner
Munger, Tolles & Olson

Dr. Lorenzo Meyer
Centro de Estudios Internacionales
El Colegio de México

Dr. Kevin J. Middlebrook
Director
Center for U.S.-Mexican Studies
University of California, San Diego

Dr. Juan Molinar Horcasitas
Consejero Electoral
Instituto Federal Electoral

Amb. Jorge Montaño
Presidente
Asesoría y Análisis, S.A. de C.V.

Mr. Sergio Muñoz
Editorial Board
The Los Angeles Times

Mr. Luis G. Nogales
President
Nogales Partners

Dr. Susan Kaufman Purcell
Vice President
Americas Society & Council of the Americas

Dr. Rogelio Ramírez de la O
President
Ecanal

Mr. Andrew Reding
Senior Fellow &
Director of the North America Project
World Policy Institute

Lic. Federico Reyes Heroles
Director General
Este País

Dr. Deborah L. Riner
Chief Economist
American Chamber of Commerce of Mexico, A.C.

Sr. Raymundo Riva Palacio
General Editorial Director
Milienio

Sr. Mario Rodríguez-Montero
Director de Relaciones Institucionales
Pulsar Internacional

Mr. Richard Rothstein
Research Associate
Economic Policy Institute

Amb. Andrés Rozental
International Consultant
Rozental & Associates

Dr. Alfredo Sandoval Musi
Professor
Economics Department
Instituto Tecnológico y de Estudios Superiores de Monterrey

Amb. Jesus Silva Herzog
Candidate of the Revolutionary Institutional Party
(PRI) for mayor of Mexico City

Prof. Jesus Silva Herzog-Márquez
Law Department
Instituto Tecnológico Autónomo de México

Dr. Richard N. Sinkin
Managing Director
InterAmerican Holdings Company

Mr. Clint E. Smith
Senior Research Associate
Stanford Institute for Economic Policy Research
Stanford University

Sen. Fernando Solana Morales
Chairman, Foreign Relations Committee
Senate of the Republic of Mexico

Rev. Msgr. Jaime Soto
Episcopal Vicar for the Hispanic Community
Diocese of Orange

Dr. Gregory F. Treverton
Acting President & Director of Studies
Pacific Council on International Policy

Dr. Georges Vernez
Director
Center for Research on Immigration Policy
RAND Corporation

Mr. Salvador Villar
President and Chief Executive Officer
California Commerce Bank

IMPORTANT BUT UNCERTAIN TRANSITIONS

Mexico today is in the midst of concurrent, linked, uneven and consequential — but yet uncertain — transitions. Mexico's economy used to be protected and inward-looking, built around a strong state role in production and distribution, but it is becoming more open and internationally-oriented, with a more streamlined state. Mexico's political system was deeply authoritarian but is evolving, however unevenly, toward more plural, responsive and even democratic governance. Mexico's institutions were highly centralized but they are being reshaped as power and governance devolve. Mexico has jealously preserved its sovereignty and independence from the United States, but powerful sectors of Mexican society now embrace North American and global integration.

Mexico's economy used to be protected and inward-looking, built around a strong state role in production and distribution, but it is becoming more open and internationally-oriented, with a more streamlined state. Mexico's political system was deeply authoritarian but is evolving, however unevenly, toward more plural, responsive and even democratic governance.

Mexico is becoming less authoritarian, less presidential, less centralized and more open to the world, all at once. Yet, like other emerging market countries attempting to open their politics and their economies, the transformations are uneven in different sectors and regions, and paradoxes abound. The presidency still can dominate the political system when it chooses, and Mexico City still is the paramount force in the country. Mexico is less authoritarian, but the army is being employed more and more to combat drugs and sustain order when local authorities cannot. Nationalist fervor, especially in parts of the south, impels politicians to reject more open economics, for instance in the electricity industry. Mexico is on the move, but its destination, indeed its destiny, remains open.

One important point is clear, however: the Mexicos that many Americans carry in their minds do not exist. Those who think of Mexico as unremittingly poor, rural, traditional and authoritarian have not kept up with the vast changes that have been reshaping much of the country. But those who portray Mexico as transformed into a modern, open, prosperous, stable and democratic nation overlook the immense problems the country is very far from having resolved. Some states in Mexico's North today enjoy per capita incomes similar to those of South Korea or Taiwan, but most of the southern states are at the level of Guatemala or Honduras.

Mexico faces huge challenges — of growth, equity, governance and accountability, education and social change. How successful Mexico will be in confronting these perplexing issues will depend on the understanding and determination of many millions of its citizens over a number of years, as well as on the international environment it confronts — an environment that, for Mexico unlike other emerging market nations, is dominated by the powerful effect of actions, both public and private, by the United States.

THE ECONOMIC TRANSFORMATION

Over the past two decades, the Mexican economy has been radically, if very unevenly, transformed. Successive governments have instituted a dramatic change of course, an ambitious economic liberalization and structural adjustment program designed to surmount the country's recurrent debt crises and "update" Mexico to changing international circumstances.

From import-substituting industrialization Mexico has moved to export-led growth; from protectionism toward open competition; from state protection to state promotion. In an effort to integrate successfully into the world economy, Mexico has attempted to deregulate its domestic markets, encourage foreign investments, place the private sector at center stage and go beyond the country's borders in search of new markets, partners and technology. In the words of scholars Hector Aguilar Camín and Lorenzo Meyer, Mexico has exchanged "the labyrinth of solitude for the supermarket of world integration."

The 1980s laid the basis for reforms but at a high price, especially for organized labor, parts of the state bureaucracy and a protected, uncompetitive business class, due to the toll wrought by the 1982 financial crisis and subsequent economic restructuring. After more than five years of a stagnant economy, high inflation, and declining wages, it was only in 1989 that Mexico began to reap some rewards from its dramatic change of course.

Between 1989 and 1994, GDP growth averaged 2.8 percent. Exports soared, and foreign investment flowed in. Following the financial market opening in 1989, the Mexican stock market rose in value from $25 billion in 1989 to $200 billion in 1993, and Mexican companies raised $16 billion in equities and an equal amount in debt between 1991 and 1994. Foreign financial institutions re-entered Mexico's financial system for the first time since the Revolution of 1910-1920. In this period Mexico was hailed as the poster child for economic opening, and President Carlos Salinas was internationally acclaimed.

Mexico has exchanged "the labyrinth of solitude for the supermarket of world integration."

But Mexico's modernization strategy faced important challenges in the mid-1990s: an indigenous uprising in Chiapas and the assassinations of the PRI's presidential candidate, Luis Donaldo Colosio, the party's Secretary General, Jose Francisco Ruiz Massieu, and Cardinal Posadas of Guadalajara punctuated a level of political violence not seen in Mexico for seventy years. The chronic current account deficit of Mexico's balance-of-payments, which reached 6.8 percent of GDP, had put the peso under pressure. Faced with a competitive electoral race, the Salinas government chose inflation-fighting and confidence-building, and did not devalue. That, coupled with expansionary fiscal and monetary policies in an election year, proved to be a recipe for disaster.

In late 1994 and early 1995 the Mexican economy suffered a devastating blow — a financial crash unleashed by a sharp, perhaps excessive devaluation of the Mexican peso that revealed the underlying weaknesses of the country's political and economic strategy. The economy contracted 6.2 percent during 1995. Wages lost over 20 percent of their purchasing power, more than two million people lost their jobs, tens of thousands of businesses went bankrupt, and the banking system would have become insolvent had it not been bailed out by the government.

Comparative Economic Performance 1983-99

	1983-88	1989-94	1995	1996-99
GDP (annual growth %)	1.1	3.9	-6.2	5.0
GDP Capita (annual growth %)	-1.1	1.9	-8.1	3.2
GDP in manufacturing (annual growth %	2.3	3.5	-4.8	8.1
GDP in services (annual growth %)	0.9	4.2	-6.4	4.2
Manufacturing employment (annual growth %)	0.9	-1.2	-8.9	3.0
Trade balance ($bn annual average)	7.0	-12.2	7.1	-1.4
Manufactured exports ($bn annual average)	7.3	33.3	66.6	99.6
Foreign Direct Investment ($bn annual average)	2.3	4.6	9.5	10.5
Portfolio foreign investment ($bn annual average)	-0.7	11.9	-9.7	5.8
Peso Real exchange rate Dls/Ps (1970=1.0)	0.7	1.0	0.7	0.9
US $ effective real exchange rate (1970=1.0)	1.1	0.8	0.8	0.9
Foreign debt, end of period ($bn)	101.8	153.0	176.5	182.1

Source: INEGI, US Department of Commerce and Ecanal for Med-Term outlook.

Faced with an escalating crisis, Ernesto Zedillo, Mexico's "accidental president," who had been quickly selected to replace Colosio, committed himself to a restrictive fiscal and monetary policies designed to stabilize financial markets, encourage an inflow of foreign capital, contain inflation and generate a fiscal surplus. Indeed, spokesmen for the Mexican government called the small fiscal deficit "an anchor of our economic policy." The U.S. government responded to the crisis by arranging a $50 billion line of credit (despite some skepticism in the U.S. Congress).

Mexican policy and the U.S.-led bail-out produced positive results: indeed, the speed with which Mexico rebounded from its debacle took both Mexicans and foreigners by surprise, and highlighted the excessive response of portfolio investors to the Mexican devaluation of December 1994. Between 1996 and 1998 GDP grew at an average annual rate of 5.5 percent. This expansion was fueled by a strong increase in investment and a gradual recovery of consumption. Per capita income began to grow by more than 3 percent during that period for the first time in many years. Exports registered an impressive growth, climbing 35 percent between 1994 and 1996. Mexico's fundamental economic conditions — budget and current account deficits of only 0.5 and 1.6 percent of GDP — and tight control over monetary policies set the stage for renewed, albeit cautious optimism, although the real wages of many Mexicans were still lower in 1999 than they had been before the 1994 crash.

Mexico weathered the Asian crisis of 1997-98 relatively well, and managed with timely fiscal adjustments to keep the public deficit within reasonable limits. Looser Mexican fiscal and monetary policies had been producing inflationary pressures before the crisis, and so the Asian flu, plus low oil prices, provided additional powerful reasons to reverse those policies. The government cut budgeted public spending three times during 1998, leading to a reduction in economic growth from 7 percent in 1997 to 4.8 percent in 1998. The contagion effect from the Russian devaluation in August 1998 and from the Brazilian devaluation in January 1999 dealt additional blows, notwithstanding Mexico's strong fundamentals. The rapid depreciation of the peso and higher interest rates further slowed down the economy.

In 1998 Mexico was also hit by substantially lower oil prices. Despite the country's efforts to diminish its dependence on oil revenues — oil exports are less than a tenth of total exports — oil income still amounts to about a third of the government's total revenue. The government responded to the oil shock with economic orthodoxy — major reductions in public spending, tax hikes, and increases in the prices of public goods and services. Inflation, which had increased to 18.7 percent in 1998, now is declining and is projected to fall to around 13 percent for 1999. Growth slowed from 7.0 percent to 4.8 percent between 1997 and 1998, and is projected at about 3 percent for 1999. The spurt upward in oil prices in 1999 gives the government more room to maneuver, but how much will depend on how high prices stay and for how long. Compared with other countries of Latin America, Mexico is without doubt among the best performers, one of the countries maintaining good economic fundamentals.

Some analysts still consider the Mexican peso overvalued in purchasing power parity terms, however. In the last year, the peso has strengthened 10 percent, from 10.4 to the dollar to 9.4. At the same time, the inflation differential between Mexico's 17 percent and the industrialized world's 3 percent has led to a deterioration of 14 percent in the country's relative competitiveness. Imports continue to outstrip exports, leading to a chronic current account deficit — about 3.5 percent of GDP though perhaps lower if oil prices remain above $18 per barrel. The deficit continues to drag down the overall growth of the economy. Since rapid growth tends to expand Mexico's deficit, the good news of economic recovery and an expanded domestic market may widen the current account deficit. That could again tempt speculators to attack the peso, but the fact that the peso now floats will allow for faster adjustments and lessen the probabilities of future speculative attacks. Mexico may be able to escape its history of major declines in the exchange rate resulting in higher inflation, higher interest rates and lower economic growth.

Compared with other countries of Latin America, Mexico is without doubt among the best performers, one of the countries maintaining good economic fundamentals.

As for other open emerging economies, external economic crises could hurt Mexico in two key areas, capital flows and exports. For instance, the unease created in the wake of Russia's devaluation and Asia's travails led to reduced capital inflows and some capital outflows from Mexico. As a result, the Mexican peso fell by a fifth in 1998. The Central Bank responded with increases in interest rates, leading to reduced economic growth in 1999. A renewal of Asian woes could affect not only Mexico's access to capital but also its exports — directly through a loss of price competitiveness and indirectly through lower growth in the industrialized economies, particularly the United States. Twenty percent of Mexican exports face competition with Asia in the U.S. market, so that another Asian crisis would bring about additional pressure on Mexico's exports.

THE NAFTA EFFECT

Free trade through NAFTA has reinforced Mexico's economic transformation and contributed to the country's capacity to adjust to international shocks, sustaining economic growth despite adverse global conditions. As NAFTA nears its seventh year, direct foreign investment — in plant, property and equipment — is booming, and volatile portfolio investment recovered somewhat in 1999 from the 1998 crisis. NAFTA has stimulated powerful forces of change in trade, investment, the environment, labor practices, finance and corporate governance. As companies from Samsung to Daimler Benz to DuPont open factories or expand existing operations, foreign direct investment has jumped from approximately $5 billion in 1993 to an average $10 billion per year recently — expanding at an average rate of 22 percent between 1994 and 1997. From NAFTA's implementation at the beginning of 1994 until 1998, Mexican trade with the United States had increased by 113 percent and with Canada by 73 percent, compared to an increase in trade between the United States and Canada of 55 percent.

Businesses that used to rely on extended family, personal friendships, and government contacts are beginning — if somewhat reluctantly — to accept professional management and even foreign direct investment, particularly in mining, retail sales, and services.

NAFTA surely has contributed to turning northern Mexico — and areas of central Mexico like Guadalajara, Guanajuato and Puebla — into reliable exporters of sophisticated products from auto brake systems to laptop computers. The number of maquiladora plants — assembly operations where inputs from abroad are admitted duty-free, provided finished goods are exported — has grown by 17 percent since the agreement was implemented, and the number of workers employed by the maquiladora industry has increased by 46 percent. More than 500,000 Mexicans make parts and assemble vehicles for eight of the world's biggest auto-makers. Since 1993 Mexican exports have more than doubled, and manufactured goods make up close to 90 percent of the country's sales abroad, up from 77 percent five years ago. Oil, by contrast, accounts for only 7 percent of exports, down from 22 percent in 1993 — partly, to be sure, a reflection of lower oil prices but also a result of increased manufacturing exports.

NAFTA, and accompanying financial liberalization, have also begun to open up Mexico's inward-looking business culture. Businesses that used to rely on extended family, personal friendships, and government contacts are beginning — if somewhat reluctantly — to accept professional management and even foreign direct investment, particularly in mining, retail sales, and services. Many large companies have adjusted successfully to Mexico's international integration and become strong competitors on the world stage. In the top ranks of Mexican business, many executives say they now consider their companies to be North American corporations. Still, the change, like others in Mexico's transitions, is uneven, and old practices persist. For instance, business leaders accustomed to closed-door negotiations with cabinet members are slow to develop ties with newly empowered legislators and members of the opposition.

Integration, however, has reinforced the existence of a two-tiered business class. Large export-oriented corporations with access to foreign financing have reaped the benefits of Mexico's industrial surge. Fifty top companies, most of them maquiladoras and multinational enterprises, account for one-half of Mexican exports and for the bulk of recent export growth. Economic power has become more concentrated in top producers with financial power; twenty major groups control more than three-fifths of national economic output. For many small Mexican companies, high financing costs are a barrier to upgrading technology. Traditional farming of grains continues to shed excess workers, who then migrate to urban areas or attempt to cross the border, while at the same time new agro-industries are gaining momentum, exporting frozen products as far away as Sweden. The labor intensive sectors of the economy — agriculture, light industry, medium-size businesses — that were the basis of rapid growth in the East Asian economies for many years, and should be the basis of rapid growth for Mexico, still cannot compete internationally.

UNEVEN STRUCTURAL REFORM

Free trade has forced Mexico to reconstruct its manufacturing industry: traditional non-competitive producers of consumer goods are being edged out by an integrated and outward-looking network of producers of industrial goods. Low productivity services are being displaced by the momentum of modernization, and a slimmer, more efficient service sector is emerging in some areas of banking services and telecommunications. Mexican companies, for example, process credit card data and airline tickets for foreign companies.

Although labor laws remain mostly unchanged, economic pressures, in Mexico as elsewhere in the world, have compelled Mexican unions to accept more flexible work practices and contract terms. Mexico is no exception to the global pattern of declining union power. That said, labor remains the major corporate organization in the PRI, and this fact, plus the growth of some independent unions, make talk of the demise of union power premature.

Technologically, the oil sector lags a decade behind major global producers. Catching up will require new investments on a scale well beyond what the government could manage.

The energy sector in Mexico remains a big question mark. Technologically, the oil sector lags a decade behind major global producers. Catching up will require new investments on a scale well beyond what the government could manage. If the exploration and production monopoly of the state oil company, PEMEX, is sustained, resources will be destroyed as oil is lost due to inefficiency. Yet if modernizing the oil industry requires new forms of foreign participation, that could become a political lightning-rod, for the nationalization of the oil industry by President Lázaro Cárdenas in 1938 is still regarded as one of his government's major achievements.

Similar political considerations surround the Federal Electricity Commission, which controls a significant part of the country's infrastructure. In 1999 the government presented to Congress proposals, requiring amendment of the Constitution, to deregulate and partly privatize the electricity industry. If these proposals were adopted, major reforms in the energy sector would be more feasible, but it is unclear whether, when or in what form these proposals will eventually be approved.

The 1994-1995 peso crisis, which quintupled interest rates, revealed the structural deficiencies of a banking system crippled by bad loans.

THE BANKING SECTOR

Nowhere are the pitfalls of structural reform better illustrated than in banking. The banking crisis that followed the 1994 devaluation became a serious burden for Mexican taxpayers, a political headache for the Mexican government, and the Achilles heel of the Mexican economy. In ways somewhat akin to the U.S. savings and loan crisis, deregulation following the re-privatization of banking in 1991-92 allowed Mexican banks to increase lending without adequate assessment of risk. Several banks lent to their own shareholders or to shareholders of other banks, and many of those loans lacked appropriate collateral. Moreover, bank supervisors, used to the nationalized banking system of 1982-92, were not trained to supervise the newly re-privatized system.

The 1994-1995 peso crisis, which quintupled interest rates, revealed the structural deficiencies of a banking system crippled by bad loans. In order to reduce the risk of a bank run that could have provoked the collapse of the whole banking system, the government rescued many of the country's banks on the verge of bankruptcy, with outstanding non-performing loans well in excess of their capital. The bail-out, which was conducted in a series of measures between 1995 and 1997, began, again not unlike the United States, with providing liquidity, and ended in the massive purchase of non-performing loans — at a cost projected in 1998 at $60 billion but now running to $100 billion in public resources, the equivalent of 22 percent of GDP. The newly created deposit insurance institution, IPAB, started by injecting $1.3 billion of public resources into the third largest bank, Serfin, and is projected to require $8.5 billion for the fourth largest, Bancrecer.

Legislation for the bail-out provoked a political fire-storm. The increasingly assertive opposition in the Mexican Congress used the occasion to expose just how much crony capitalism in the banking system had raised the price of the bail-out. Opposition parties argued that the government rescue was illegal, and claimed that both the privatization and subsequent rescue were tainted by corruption and illegal behind-the-scenes maneuvering between prominent bankers and their allies in the Mexican government. In the end, though, Congress grudgingly assented to converting the resources used to bail out the banks — through an entity designed to protect depositors, known as FOBAPROA, into public debt. Forty-five percent of bad loans were sold to FOBAPROA, loans were restructured and the IPAB was created to oversee the disposal of assets and provide deposit insurance.

Despite the rescue, Mexico's banking system is hardly out of the woods, and it has a long way to go before meeting the requirements of the world economy. The Mexican Congress conditioned its approval of the bank rescue on a relief program for debtors, but the actual amount of relief was small in the end. To recover, the banking sector needs low interest rates and high growth rates, but interest rates remain high, and high growth has yet to occur. It will also be necessary to overhaul the legal infrastructure for lending, including new provisions for creditor and debtor rights, and mechanisms for both enforcement and bankruptcy.

In addition, the banks need at least to double their capital, considering the many bad loans they still carry. The liquidity crunch remains, and it is unlikely to disappear until a successful program of selling off distressed banking assets by the new IPAB is initiated. Since the 1995 crisis, the banks have added capital mostly by selling assets and by attracting foreign investors. Foreign participation in the financial system, prohibited since the Revolution, is on the rise, and is changing the face of Mexican finance. At the end of 1998, foreign-controlled banks managed approximately 16 percent of total deposits and banks with foreign participation controlled a further 58 percent. The limitation on foreign ownership in the three largest banks was lifted in 1998. Ownership of the country's banking is being "foreignized," making it possible to foresee a system dominated by Spanish, U.S. and Canadian banks in alliance with Mexican interests.

On the positive side, Mexico has sought to increase domestic savings and so reduce its dependence on foreign financing. An ambitious, long-term reform of the pension system aims to increase savings from 19.6 percent of GDP to 22.5 percent. The plan switches management of the obligatory pensions paid by companies from the Mexican social security institute, a government body, to private sector pension funds specially set up for the purpose. By mid-1999, there were more than fourteen million workers enrolled in the system, all with their own pension fund and bank accounts. The ultimate aim is to create not just long-term capital markets but also a new savings culture, as has occurred in Chile.

TO DOLLARIZE OR NOT?

Following a period of currency stability between 1954 and 1976, all of Mexico's economic crises (1976, 1982, 1987, and 1994) were characterized by currency collapse, and between 1976 and 1998 the currency devalued by a hundred percent, with incalculable effects on Mexicans' political and economic self-confidence. The exchange rate and its volatility will be crucial to Mexico's macroeconomic prospects. Perhaps surprisingly in a country long deeply ambivalent about its neighbor to the north, a debate has begun over whether to "dollarize" — that is, tie the peso irrevocably to the dollar through a currency board, as in Argentina, through unilaterally adopting the dollar, as did Panama, or through a monetary union, such as the Euro in the European Union.

Perhaps surprisingly in a country long deeply ambivalent about its neighbor to the north, a debate has begun over whether to "dollarize"

After the 1995 crisis Mexico adopted a floating exchange rate regime, which has considerable advantages over the previous system of mini-devaluations. That earlier crawling peg was orderly in good times but dangerous in bad, when it gave currency speculators an attractive one-way bet. For this reason, Thailand, Indonesia, Russia and Brazil all abandoned the peg in the wake of the recent financial crises. Floating is more transparent and prevents the government from deviating too far from economic fundamentals. It also forces automatic corrections in the trade balance, and in the last several years, it has absorbed much of the impact from global currency jitters. However, if another crisis ensued, Mexico could again face the risk that markets would overreact, as in 1995, driving the peso down, with both inflation and interest rates rising, to the ultimate harm of the real economy.

Opinion polls show Mexicans open-minded about dollarization. For many Mexicans with relatives in the United States, "dollarization" is a fact of life. Moreover, most Mexicans have some sense for the cost of the huge devaluation of the peso: not only has an estimated $100 billion in Mexican savings been driven offshore, but currency uncertainty is the main culprit for very high real interest rates, which choke off growth. In this light, not only do growing economic ties through NAFTA with the United States and Canada make dollarization seem natural, but other global precedents seem positive as well. The Euro was introduced in 1999, and there has been speculation that Argentina would seek to upgrade its currency board into a full adoption of the dollar. Argentina and Hong Kong, with their currency boards, both weathered the 1997-98 financial crises relatively well.

If it dollarized in whatever form, Mexico would, in effect, pay for exchange rate stability by ceding control of its interest rates to the U.S. Federal Reserve. It would thus lose monetary policy as a way of offsetting external shocks, and it would have to find some alternative to its central bank as a lender of last resort. The argument against dollarizing holds that Mexico, much poorer than the United States, might prefer faster growth even at the price of some inflation. The government has certainly not sought to build a constituency, in either Mexico or the United States, for moving to the dollar or a currency board. Dollarization will not form part of the presidential election debate in 2000, as all Mexican parties will fear being accused of a lack of patriotism, but the issue will rise on the Mexican agenda in the first years of the new century.

ECONOMIC POLICY OPTIONS

Mexico's economic future is inextricably tied to the country's politics. That is true at all times for all countries: national leaders make economic decisions not just on the basis of their economic merit, broadly conceived, but on their political effect. Yet the 1994 financial crisis underscored how extraordinarily politicized Mexico's economic system was. Decisions were made primarily on the basis of their perceived impact on the political and personal stakes of key players, including the president.

In contrast, the Zedillo government sought to place economic policy in the hands of technocrats, and thus insulate it from the wear and tear of politics — an intention symbolized in the monetary area by the appointment of former Finance Minister Guillermo Ortiz as head of the Central Bank which had been made autonomous in 1994, the last year of the Salinas administration. In another effort to insulate the economy from political noise, Mexico arranged up to $24 billion in contingency lines of credit to cover debt servicing and avoid a repeat of 1994's speculative attacks on the peso during the year 2000 elections.

Insulating economic policy, however, presupposes a degree of consensus that does not yet exist in Mexico. In the context of a less vigorous economy, opposition leaders have begun to call for a revision of the economic "model" of free markets, free capital mobility, and fiscal and monetary discipline. They seek to map out a "third way" for Mexico, one that would entail a combination of market forces and increased social spending designed to sustain incomes and distribute gains more equitably.

In the context of a less vigorous economy, opposition leaders have begun to call for a revision of the economic "model" of free markets, free capital mobility, and fiscal and monetary discipline. They seek to map out a "third way" for Mexico, one that would entail a combination of market forces and increased social spending designed to sustain incomes and distribute gains more equitably.

Yet not only do the constraints of international finance seem to veto dramatic alternatives, the rhetoric of all the major party leaders suggests a battle for the political center. Polls report that the extremes — rough-and-tumble capitalism or big government — are equally unacceptable to most Mexicans. When asked to choose between alternatives for job creation, new social programs or private sector growth, in a 1995 national survey, 80 percent of respondents opted for the latter. Mexicans do express opposition to specific liberalizations of PEMEX, CFE, and the health care system, but in general are more concerned about losing existing social safety net programs than about creating new ones.

A COUNTRY DIVIDED

Mexico today is really five Mexicos — one in the south, one in the north, one comprising Mexico City and its environs, one directly along the border with the United States and a fifth encompassing those Mexicans living temporarily or permanently in the United States. It is a country of deep inequalities, riven in particular by the cleavage between North and South. A modern, increasingly prosperous — and rapidly democratizing — North coexists with an impoverished, marginalized South. Indeed, the gap between Mexico's North and South is about as great as that between the United States and Mexico as a whole. Northerners live longer, earn more, vote more frequently, and are better educated than southerners. Economic cleavages often occur within states themselves, for in the south there are islands of prosperity (Cancún and Acapulco, for example) surrounded by poverty, and in the north rich regions co-exist with poorer ones (southeastern Sonora, central Chihuahua, northern Coahuila). In some southern states, decentralization has opened space for local elites to preserve authoritarian rule. Some, such as Chiapas and Guerrero, suffer the twin evils of ungovernability and guerrilla violence. Politically speaking, too, Mexico is many Mexicos.

Mexico today is really five Mexicos — one in the south, one in the north, one comprising Mexico City and its environs, one directly along the border with the United States and a fifth encompassing those Mexicans living temporarily or permanently in the United States. It is a country of deep inequalities, riven in particular by the cleavage between North and South.

This North-South divide reflects the overlap of poverty, population, and ethnicity. It is not new; it dates back to colonial times and persisted through the prosperous oil boom era of the late 1970s. Mexico's indigenous population — 12 percent of the total — is concentrated in the South, which is also home to Mexico's poorest citizens; the average wage in Mexico's southern states is only a third or a fourth that on the Mexican side of the U.S. border. The twenty municipalities with the highest index of "marginality" are located in the southern states of Oaxaca, Guerrero and Chiapas. Fertility rates in the South are much higher, with families averaging 5.8 children, more than twice the national average.

The economic opening of the last decade has exacerbated the North-South cleavage. The "losers" — the struggling business sectors competing with imports that in numbers are a majority of Mexico's firms — tend to cluster in central and southern states. States such as Oaxaca and Chiapas lack the education, the technical skills, and the stable business climate necessary to engage in the export economy, while northern states such as Nuevo León, Baja California and Chihuahua are emerging as economic powerhouses. Mexico's GDP is roughly $400 billion dollars, one twentieth that of the United States. And of that, only 15 percent is produced in the southern half of the country. Mexico's 96 million people have a per capita GDP of approximately $4,000, or one-seventh that of the United States' 265 million people, at approximately $28,000.

Moreover, income inequality within regions in Mexico is also rising, and so the country faces the dual challenge of deep regional disparities and profound income inequalities. Across the country, economic modernization has nurtured a new elite of skilled Mexican workers who can earn substantially more than the $1.20 per hour of a typical Mexican factory worker. By official statistics, unemployment has declined, but those numbers do not account for the millions of Mexicans employed in the informal economy, where they often earn well below the official minimum wage while working in several jobs. Mexico faces a chronic shortage of jobs, for it needs to generate one million new ones a year just to absorb young people entering the workforce. A sixth of Mexico's population subsists on less than a dollar a day, and forty percent gets by on less than two dollars. Poverty breeds crime and migration, both of which are on the rise.

Fewer than half of Mexicans study beyond ninth grade. Of every 100 primary school graduates, only two will attend college, and only one will graduate. National illiteracy still stands at almost 11 percent of the population. A child in Chiapas receives an average of 3 years of education, in contrast to 12-13 years in Mexico City and the northern states.

Fewer than half of Mexicans study beyond ninth grade. Of every 100 primary school graduates, only two will attend college, and only one will graduate.

THE CHIAPAS QUAGMIRE

The conflict in Chiapas is a symbol of these divisions. In one sense, it has been exaggerated by timing — it erupted the day NAFTA went into effect — and by the attention of international media and non-governmental organizations. The conflict mostly has been contained in Chiapas, and while the government's armed opponents have some national sympathy, they do not have much actual support. Yet the conflict has been a powerful stimulus both to bringing new actors onto the Mexican political stage and to altering the roles of existing ones.

The roots of the conflict run back to the beginning of Mexico's history. Colonial governments accepted the existence of indigenous peoples but made little effort to integrate them into national life. For much of the nineteenth century, governments neither accepted nor integrated those indigenous communities. The 1910 Revolution led to a bargain in which a paternalistic state would provide the indigenous peoples with material benefits — land, education, agricultural subsidies, social welfare programs — in return for political subordination; the indigenous peoples would be integrated but not really accepted.

This bargain prevailed in Chiapas for more than five decades but began to unravel with large-scale migrations to Chiapas touched off by land reform there in the 1970s and then by the economic changes of the late 1980s and early 1990s. The restructuring led to the withdrawal of state subsidies, including those for the production of coffee, a key economic activity among peasants in Chiapas. NAFTA entailed eliminating price supports for basic grain producers, and the Salinas reforms to the constitution spelled an end for further land reform. Chiapas peasants were left to fend for themselves.

The Chiapas conflict is far from a simple confrontation between indigenous peasants and an indifferent government. It overlays ethnicity, class, land tenure, and religion. Chiapas is in many ways a war of the poor against the poor

The militancy of the indigenous poor had also been spurred by religious groups in the state, as the Catholic church in the region sought to express the tenets of its most radical social teachings while combating the growing influence of Protestant evangelical sects. Meanwhile, Subcommander Marcos, the charismatic leader of the Zapatista Army of National Liberation (EZLN) —named for revolutionary hero Emiliano Zapata who fought for landless peasants in his home state of Morelos — had spent over ten years in the jungle, building a wide base of support for a rebellion. The Zapatista revolt became the spark for a rich tinder of grievances — poverty and oppression, racism and neglect, grassroots militancy, and religious strife.

The Chiapas conflict is far from a simple confrontation between indigenous peasants and an indifferent government. It overlays ethnicity, class, land tenure, and religion. Chiapas is in many ways a war of the poor against the poor, with the Zapatistas fighting not just the political elite in Mexico City but also other indigenous groups that do not support their military stance, and small landowners struggling with their neighbors over land.

Since the beginning of the conflict in 1994, government policies have swung between accommodation and repression, between negotiation and military action. The Zedillo government offered the EZLN a peace initiative in the form of a law that would modify relevant articles of the Mexican Constitution to grant limited autonomy to indigenous groups in Chiapas. At the same time, it hardened its position toward Zapatista sympathizers in Chiapas, particularly foreigners. In what has become a war of symbols, images, and words, the government has played on the traditional Mexican distrust of foreigners, expelling more than sixty from Chiapas.

For their part, the Zapatistas assert that the government backed away from the accords reached in San Andrés Larráinzar in February 1996. The EZLN may be stalling for time until after the 2000 elections, hoping that the next president will be more sympathetic to their cause than Zedillo. Thus, intransigence by both government and guerrillas, combined with succession politics, push peace in Chiapas further away than ever.

NEW ACTORS, NEW ROLES

NGOs: Pushing for Change from the Bottom Up

Since the mid-1980s a broad array of grassroots movements and other non-governmental organizations (NGOs) has emerged, working outside the channels of the traditional political parties. The 1985 earthquake in Mexico City was a critical moment: the government's paralysis in the face of the earthquake sparked the rise of independent civic and neighborhood organizations, working together to solve specific problems. The empowerment of these groups eroded traditional perceptions that political and social demands invariably had to be channeled through the PRI. For the first time, civic organizations began to incorporate the issue of government accountability into their mental maps. Subsequently, many jumped into the political fray and supported the presidential bid of Cuauhtémoc Cárdenas in 1988.

In the aftermath of the turbulent presidential race that year, many civic organizations began to concentrate their energies on electoral reform and human rights abuses. Hotly contested elections during the Salinas term, often widely considered fraudulent, spurred the birth of groups like Alianza Cívica (Civic Alliance), Causa Ciudana (Citizen Cause) and Movimiento para el Cambio Democrático (Movement for Democratic Change). Since the late 1980s, these groups have carried out independent election observations and produced critical reports on local elections that stressed the ruling PRI's dubious practices. Citizen mobilization around electoral concerns also led to a growing convergence between human rights organizations — such as the Mexican Human Rights Academy — and pro-democracy groups. Increasingly, leaders of civic groups began to view political rights as human rights and thus subject to international protection and promotion. They joined forces with international organizations — election observers, professional associations, foundations, religious and social movements — and laid the groundwork for a network of transnational alliances focused on political change in Mexico.

The Chiapas rebellion was another catalyst for civic organizations, and it also helped open the country's politics to external scrutiny. Media coverage of the military confrontation in the Chiapas hillsides elicited outrage at home and abroad and led to an influx of human rights organizations into the region. The Mexican government could not keep international and domestic NGOs from establishing a presence in the region. Over 5,000 foreigners fanned out over the highlands to participate in, report on, or do research about the drama as it unfolded, and more than 45 U.S.-based organizations convened in Washington in 1998 to set the groundwork for a Solidarity Network

As these events made clear, Mexico's opening to the world has rendered the Mexican government more accountable to constituencies beyond its borders, and actors in Mexican civil society constantly interact with their counterparts abroad. Democracy, human rights, and indigenous rights have become issues that run well beyond the exclusive domain of the Mexican government.

During the 1994 presidential election civic organizations and their international allies played a significant role. International visitors and domestic observation groups helped ensure greater transparency in the electoral process. Civic organizing minimized campaign violence and encouraged voter participation, and thus strengthened the concept of citizenship and citizen involvement in politics.

Composition of the Lower House

Party	Number of seats	Percent
PRI	239	47.8
PAN	121	24.2
PRD	124	24.8
PT	7	1.4
PVEM	6	1.2
Independents	3	0.6

Composition of the Senate

Party	Number of seats	Percent
PRI	73	57.48
PAN	31	24.4
PRD	16	12.57
PT	1	0.78
Independents	6	4.7

PRI: Revolutionary Institutional Party
PAN: National Action Party
PRD: Revolutionary Democratic Party
PT: Workers' Party
PVEM: Mexican Green Party

Source:REFORMA database

Congress: Emboldened and Empowered

For the first time since the PRI's inception in 1929, Mexico is experiencing a true legislative life. In a break with its docile past, the Mexican Congress has turned into a battlefield, replete with frontal attacks, strategic retreats, seemingly endless negotiations, and potential stalemates. The PRI retains control of the upper house, but the two major opposition parties currently command a majority in the lower house. Government officials are forced to defend their proposals, and congressional lobbying is becoming an integral part of the country's political landscape.

Yet the empowerment of Congress also implies divided government. Congress has undergone a pendulum shift: in the past, it acted as a rubber stamp for presidential initiatives; today it has swung toward the opposite extreme, questioning almost every proposal. A minimum reasonable level of consensus is lacking, and last-minute deals brokered between the PAN and the PRI — such as those relating to FOBAPROA and a set of electoral reforms — have become the norm. Bogged down in personalized and politicized struggles, Congress often has taken months to pass minor legislation. PRI control of the Senate has meant that many PAN-PRD initiatives never see the light of day. The 2000 elections will bear on the future of divided government; a key question is whether PRI retains control of the Senate, where all the seats are up for election.

Independent Electoral Authorities

Independent electoral authorities are another new force on the Mexican political landscape. As part of a package of electoral reforms approved by the PAN and the PRI in 1996, the Federal Electoral Institute (IFE), once part of a PRI-controlled bureaucracy, became completely independent of the government. The IFE's General Council is currently composed of eight representatives and a president, selected by consensus among the parties that are represented in the lower house of Congress. In the past, the ruling PRI was a contender and also a judge: it participated in elections and also ran them. Today, in contrast, the IFE operates without any direct intervention by the government.

As a result, political parties compete on a much more level playing field. Although the 1994 presidential elections were the cleanest in Mexican history, the PRI clearly benefited from its control over public resources, its close alliance with the country's main television network, and its capacity to practice pork-barrel politics. Since then, new rules have been adopted to regulate campaign financing, supervise campaign spending and party income, and establish limits on personal contributions. Opposition parties have gained greater access to the media through a more equitable distribution of resources and media time. Post-electoral disputes have been shifted from the political to the legal arena through the creation of impartial electoral tribunals. Finally, new rules on party registration allow the formation of political organizations that can receive public financing and form alliances with parties in order to present common candidates.

These reforms are dramatic, but there is a daunting agenda for further reform, including limits on pre-campaign spending, the voting rights of Mexicans living abroad, and electoral laws at the state level. And even though the IFE stands out as one of the few impartial, independent, and respected institutions in Mexico, its reputation could be tarnished by the intensity of political warfare among the parties. After the IFE decided to investigate charges of electoral irregularities allegedly committed by the PRI in the 1994 election, the ruling party responded by announcing its intention to subject four of the IFE's Council members to a "juicio político" — an impeachment trial. Beginning to undermine the IFE's credibility could put the PRI in a position to cry "foul play" if it lost the next election, arguing that IFE's partiality led to an illegitimate result.

The Media: An Emerging Fourth Estate

Mexico's media are coming of age as a political force. Independent journalists are helping undermine decades of authoritarian rule, and for the first time in the country's history, the media is becoming a true "fourth estate," both a watchdog and a stage for democratic politics.

for the first time in the country's history, the media are becoming a true "fourth estate," both a watchdog and a stage for democratic politics.

Past Mexican governments muzzled the media by buying off journalists or threatening them. Journalists were often on the public payroll and were expected to act as propagandists for the regime. A few still conduct themselves in this manner, but the Mexican media's financial independence has inaugurated a new era of critical journalism, led by a cadre of journalists more intent on breaking the news than on supporting the ruling party. The written press in particular has spearheaded this dual process of professionalization and critical analysis.

The country's political transition has also forced television, overwhelmingly the dominant source of news for most Mexicans, to march to the beat of a more democratic drummer. In the past, the TV giant Televisa effectively functioned as a public relations firm for the Mexican government, and its former owner, the late Emilio Azcárraga Milmo, reiterated that he was "a soldier of the PRI." As a result, during the 1988 presidential race, opposition candidates were nearly invisible. Televisa and tightly controlled government networks allotted only 5 percent of their time to Cuauhtémoc Cárdenas. Today, more competitive and privatized television stations have been forced — both by ratings and the demands of the autonomous Federal Electoral Institute — to provide more inclusive and fairer coverage.

However, this aspect of Mexico's transition is also uneven. Traditional methods of coercion and control persist. Highly visible journalists at large newspapers or outspoken weeklies are protected by their affiliation, but writers linked to smaller, less powerful papers in the provinces are frequently repressed. Radio and television are becoming somewhat more pluralistic, but instances of visible bias or outright censorship recur.

If the powers that be can still intimidate, cajole, and blackmail the media, albeit at greater cost and with less success, official censorship may matter less than self-censorship. The order to tone down a story or stay away from a topic will come from the head of the television station or the newspaper himself, not the PRI. Another problem is that young, aggressive reporters often do not know how to behave in a context of greater political opening. They have been trained to focus on political maneuverings behind the scenes, among opaque PRI politicians, not how to analyze polls or the workings of more open politics.

In other respects, though, Mexico's media are becoming "modern" like many in the United States, where the market often blurs the line between news and entertainment. Instead of engaging in systematic reporting, reporters frequently follow the allure of muckraking. Coverage tends to center on personalities more than parties, on scandal more than substance, on the tiffs between presidential candidates more than their rival proposals for the country.

The dramatic increase in crime and recurrent scandals involving prominent politicians have provided journalists with almost unlimited grist for their mill. In Mexico, as in the United States, "if it bleeds, it leads." The result in both countries is a vicious cycle that seems hard to break. The media's insistent coverage of scandal, violence and fluff seems to sell, yet at the same it could fuel greater public cynicism not just about the political process, but about the media as well.

Extra-Institutional Actors: Drug-trafficking and Organized Crime

Mexican politics are becoming more institutionalized, and more actors are willing to play by the rules of the game, but several crucial groups still operate at the margins of established politics, or beyond. According to U.S. Drug Enforcement Agency (DEA) estimates, Mexico earns more than $7 billion a year from the drug trade, employing roughly 200,000 people. As much as 70 percent of the South American cocaine bound for the United States market enters through Mexico; Mexico also supplies between 20 and 30 percent of the heroin consumed in the United States and up to 80 percent of the imported marijuana. For Mexico, shooting incidents between rival gangs have become commonplace, and the editor of a Tijuana weekly, *Zeta*, was gunned down by drug traffickers attempting to curtail investigative reporting into their activities.

The extent of drug-related corruption is hinted at by a string of high-profile scandals and murders in recent years. The enormous profits from drug smuggling, made possible by the demands of the large U.S. market, provide the means to corrupt, giving rise to a cruel paradox: the government's drug enforcement is undermined by the corrupting influence of the drug trade, yet the drug trade cannot survive without the protection of compromised elements within the government. One study found that cocaine traffickers spend as much as $500 million a year on bribery, more than double the budget of the Mexican Attorney General's office.

Mexico tripled its federal anti-drug budget between 1987 and 1989 and tripled it again in the 1990s, particularly striking during a time of deep cuts in overall government spending. Yet all the effort has barely made a dent in a multi-billion dollar business that taints virtually every echelon of the Mexican officialdom. In the short run, stepping up anti-drug efforts has meant breaking some of the unwritten rules that had come to govern relations between drugs and politics, in particular by arresting regional drug lords. The result has been more violence and retribution, particularly in the northern states.

It is often difficult to distinguish those responsible for policing smuggling from the smugglers themselves. A report by the Interior Ministry estimated that by 1995 there were about 900 armed criminal bands in the country, of which more than half were made up of current or former law enforcement agents. Police often double as drug enforcers and as drug-smuggling protectors. When Sinaloa drug cartel leader Hector "El Guero" Palma was arrested in 1995, he was at the home of a local police commander, and the majority of the men protecting him were federal judicial police whom he had bought off. Violent conflicts often erupt between police and military personnel acting as law enforcers and similar personnel operating as lawbreakers.

Public insecurity and the decay of the judicial system rank with guerrilla warfare and drug-related violence as key preoccupations of Mexicans today.

When drug corruption scandals blow up in Mexico the official response typically is to fire or transfer individual officers and at times disband entire agencies and create new ones. For example, a report by the Attorney General's office indicated that over 400 agents of the federal judicial police (more than 10 percent of total) were fired or suspended between 1992 and 1995 on drug-related charges. Yet in 1996 the same report estimated that 70 to 80 percent of the judicial police were corrupt. Many fired police officers have simply been rehired in other regions of the country.

Public insecurity and the decay of the judicial system rank with guerrilla warfare and drug-related violence as key preoccupations of Mexicans today. Mexico City, not known five years ago for especially high crime, now has over two million reported crimes a year, and 98 percent of them result in no action by the authorities. Street crime, kidnappings, and killings by organized gangs of former policemen, protected by corrupt officials, leave Mexicans of all classes feeling helpless and outraged. The former governor of the state of Morelos was cited as a key figure in a deadly kidnapping ring. A former attorney general

Regarding the rule of law, as elsewhere in Mexican life, old patterns have been destroyed but new ones have not yet been created.

was charged with money laundering and murder. A former general at the helm of anti-narcotics operations allegedly was on the payroll of drug-traffickers.

Regarding the rule of law, as elsewhere in Mexican life, old patterns have been destroyed but new ones have not yet been created. The rise in crime and corruption among law enforcement officials is to some extent an indirect and troublesome by-product of the country's political transition. Democracy, for all its virtues, has fed insecurity; as power becomes increasingly decentralized, the presidency has gradually lost control over key levers of government, including the police. The breakdown of authoritarian rule has provided police with unprecedented discretion, and some use that enhanced power for private gain — a temptation compounded by low salaries. The advantages that effective democratic governance might eventually provide in terms of accountability have not yet been achieved in Mexico.

The Military: New Roles, Unpredictable Consequences

Mexico's armed forces, unlike those in most other Latin American countries, have remained out of politics since post-revolutionary times; they have been quietly and consistently loyal to the ruling PRI since the 1920s. Now, however, they are being thrust into new roles in combating drugs and crime, roles that both put the military in the limelight and strain its traditions of unity and loyalty.

The military's anti-drug effort has expanded, and by the late 1980s, one-third of its budget was devoted to that purpose, with some 25,000 Mexican soldiers involved in drug control operations — compared with only 5,000 in the 1970s. As a result, the military has become the supreme — and in some cases virtually the only — authority in parts of Oaxaca, Sinaloa, Jalisco, and Guerrero. The military's traditional anti-drug mission was destroying crops, but corruption in Mexican law enforcement has generated pressure to turn to the military for more drug-control tasks.

However, militarizing the war on drugs also risks corrupting the military, as a series of high-profile drug-related scandals have revealed. In February 1997, the head of the anti-drug agency, General Jesus Gutierrez Rebollo, was arrested on charges of working for the Juárez cartel, and in March of the same year General Alfredo Navarro Lara was arrested for attempting to bribe the head federal justice official in Baja California on behalf of the Tijuana cartel. Despite the risks, the militarization of law enforcement has continued, driven by the drug wave and by the increasing lawlessness of Mexico's cities; the military has been put in charge of federal police functions in at least eight states.

The Chiapas uprising in January 1994 also thrust the military into a more public, powerful and controversial role. Rumors circulated that Chiapas divided the military: some were thought to argue in private that the military should not be devoting its time to the "political containment" of the indigenous peoples of Chiapas, while other officers reportedly pushed for a decisive use of force in order to resolve the conflict as quickly as possible.

Strains within the military became visible when in 1998 about fifty Mexican military officers marched down Paseo de la Reforma, Mexico City's main boulevard, and declared the creation of the "Patriotic Command to Raise the Consciousness of the People." The leader of the group declared his admiration for Venezuela's Hugo Chávez — the military leader imprisoned after a failed military coup but subsequently elected to the presidency — and his sympathy for the Zapatista cause in Chiapas. The military quickly responded to the episode, jailing the officers involved on sedition and insubordination charges.

Still, this public manifestation of dissidence within a highly disciplined institution came as a shock. Other officers have questioned government policies and the alleged "abuses of authority" committed by the Ministry of Defense. In one high-profile case, a general was given a long prison term for misusing military funds, a sentence viewed by many Mexicans as a reprisal for his vocal criticisms of the military justice system. The future of the Mexican military is now in question in a way it has not been for seventy-five years.

The future of the Mexican military is now in question in a way it has not been for seventy-five years.

THE UNFINISHED POLITICAL TRANSITION

New global economic pressures, new actors, new dynamics across regions and between them and the center: all have eroded the PRI's dominance and opened avenues of political change. The transition from authoritarian rule is well underway, but the transformation is taking place at different speeds in various arenas, and the final outcome is unclear.

Change has come most quickly in the realm of federal elections. Mexico is becoming an electoral democracy where parties compete on a reasonably level playing field, electoral results are viewed as legitimate, and electoral authorities are recognized as impartial. Yet state and local elections are often still disputed events. Mexico has clean elections but not clean politics, and the latter will only be achieved through increased regulation of campaign and party financing. The major political parties, including the PRI, are groping toward democratizing their internal procedures. Actors outside democratic politics still threaten democracy. The Chiapas stalemate, in particular, underscores both the lack of change in the South and how much remains to be done beyond the electoral arena.

A Democratized Presidency

The Mexican system was built around a very strong presidency, following the tradition of the Aztec Tlatoani, the Colonial Viceroy, and the nineteenth century dictatorship of Porfirio Diaz. But that is changing. After the creation of the ruling party in 1929, the president ruled supreme as head of a disciplined, loyal, and broadly united PRI, and at the helm of a system devoid of checks and balances. A number of factors account for the move away from traditional *presidencialismo* — economic crisis discrediting government leadership, new actors challenging it, and more open media disclosing the corruption of previous presidents — but it is also the product of a deliberate decision by Zedillo. He has inaugurated a new presidential style, less interventionist and more discreet, and has sought to strike a balance between what he calls a "modern" presidency and what his critics perceive as a weak one.

Because this change in the presidency is so dependent on Zedillo, it could be reversed in part by his successors, given the broad range of presidential discretion enshrined in the Constitution. Nevertheless, the change under Zedillo is dramatic because presidential authority was the linchpin of the system. On the one hand, a less interventionist presidency is strengthening other political actors, including legislators and opposition party leaders, thus contributing to more accountable politics. On the other hand, though, given the weakness of other institutions, Zedillo is criticized for abdicating responsibility and creating problems, not solving them. Traditional PRI bosses have taken advantage of perceived presidential weakness to strengthen their personal fiefdoms in states such as Tabasco, Yucatán, and Puebla.

Although Zedillo's stance has helped democratize the political system, some leaders in his party feel the PRI is paying at the polls for the president's economic policy and his detachment from the ruling party. Many *priistas* — hard-liners included — are beginning to reject the top-down directives and unquestioned discipline that characterized the PRI in the past, and one consequence is that opposition within the PRI to Zedillo's open-market policies has grown. These tensions were apparent in May 1999 when the PRI formally abolished the *dedazo* — the president's right to handpick his successor — in favor of a national primary. The change was a striking opening, but it also opened the field for Zedillo's opponents in the party, Roberto Madrazo, governor of Tabasco and Manuel Bartlett, ex-governor of Puebla.

The PRI is becoming more fragmented, less national and more regional.

Today, the PRI is divided. It confronts the growing pains of a more competitive party system, where electoral victories are by no means assured and whose results cannot be orchestrated from above. Accustomed to obeying *la linea* — the presidential line — the PRI is still searching for new processes in the face of a president who seems more devoted to economic and political reform than to the continued primacy of his party. The PRI is becoming more fragmented, less national and more regional. A strong PRI in Tamaulipas and Coahuila coexists with a weak one in Mexico City and Querétaro.

These tensions have been especially visible in the party's quandary over how to select candidates. It has experimented with different formulas in different places, leading to widely divergent outcomes. An open primary in the state of Chihuahua selected a popular candidate who went on to win the governorship, after a PAN governor had ruled the state for the previous six years. In Tlaxcala, Zacatecas and Baja California Sur, when the PRI national leadership imposed candidates, popular local PRI politicians ran on the ticket of PRD, which then won. In still other states, incumbent governors have resorted to heavy-handed tactics in order to install their hand-picked successors.

Decentralization and Devolution: Promises and Pitfalls

The second political transition is related to the first: not only is the Mexican system no longer characterized by tight control of the presidency, it is also no longer so dominated by the center, Mexico City. The decentralization of power, begun under Salinas and accelerated by Zedillo, has created a new political landscape where opposition party governments share power with their PRI counterparts. Zedillo inaugurated a "new federalism," with a substantial and rapid devolution of financial — and political — resources from the federal to the state to the municipal governments. Opposition party leaders now govern in 10 of 31 states, with over half the population. Divided government, once the exception, is becoming the norm.

States Governed by Opposition Parties

Aguascalientes	PAN	Felipe González
Baja California	PAN	Alejandro González
Baja California Sur	Opposition Alliance	Leonel Cota
Jalisco	PAN	Alberto Cárdenas
Guanajuato	PAN	Ramón Martin
Nayarit	Opposition Alliance	Antonio Echevarria
Nuevo León	PAN	Fernando Canales
Queretaro	PAN	Ignacio Loyola
Tlaxcala	Opposition Alliance	Alfonso Sánchez
Zacatecas	PRD	Ricardo Montreal

Source: REFORMA database

Like the restrained authority of the presidency, decentralization also opens space for old-guard *priistas*. In states and localities still controlled by the PRI, modernizers and traditional party leaders struggle over issues ranging from electoral fraud and unfair electoral competition to human rights violations and unresolved labor disputes. Zedillo has adopted a "hands off" approach to these challenges, intervening only once they provoked violence serious enough to attract the attention of the international media. The president's reluctance to become involved in "local" political conflicts has contributed to a growing fragmentation and lack of discipline within the PRI. Mexico may see a growing gap between the national-level democratization process and what is happening in PRI-controlled authoritarian archipelagos at the state and local level.

Looking to 2000

The 2000 presidential elections will both affect and reflect Mexico's deeper transitions. Despite the PRI's travails, it is wrong to predict its demise. In 1998 and 1999 it increased its share of the vote in state elections despite the FOBAPROA scandal and the political fallout from three budget cuts. It is the only party with a truly national presence and remains the front-runner for the presidency in 2000 unless it splits or the main opposition parties can still somehow, against all odds, overcome ideological differences and personal egos to form an alliance behind a single candidate. The PRI's first-ever primary — based on extensive mobilization of the vote — resulted in a landslide victory for long-time PRI bureaucrat, Francisco Labastida, and left the party well positioned for the presidential race.

On the center-right of the political spectrum, the PAN, led by Vicente Fox, the party's presidential candidate and a self-styled outsider, has gradually extended its support beyond the urban middle class toward a stronger national presence. However, it is also divided. One faction fears that the congressional alliance with the government, for instance on FOBAPROA and the budget, tars it with unpopular policies. Other party leaders maintain that the PAN should continue to play the role of "responsible opposition" in the eyes of foreign and domestic investors and the conservative middle class. It is also unclear whether Fox's anti-establishment, faintly populist reputation will be a plus or a minus in a party whose traditional leaders are deeply conservative and had traditionally been closely associated with the Catholic church.

Mexico's transitions have cast a glaring light on the country's precarious, uneven and limited rule of law.

Meanwhile, on the Mexican left the PRD had for several years lagged behind its adversaries and seemed condemned to be the beleaguered third wheel of Mexico's party system. And yet in the 1997 mid-term election the PRD won the mayorship of Mexico City and surpassed the PAN's representation in Congress. It then won the governorships of Zacatecas, Tlaxcala, and Baja California Sur, victories that, however, also were ironically a reminder of the party's weaknesses, for it emerged triumphant only because it was able to put forward as candidates disgruntled PRI politicians who had bolted from the ruling party. The PRD too is divided, and it faces competition from some of the newly created smaller parties. Its greatest challenge is to become a party, not just a loosely knit political vehicle for Cuauhtémoc Cárdenas.

BUILDING THE RULE OF LAW

Mexico's transitions have cast a glaring light on the country's precarious, uneven, and limited rule of law. There, too, patterns inherited from the colonial past that seemed to serve tolerably well during Mexico's authoritarian, inward-looking one-party rule are grossly deficient now: when direction from the center has less legitimacy, when crime is exploding and corruption is much more exposed, and when local and foreign investors require equitable, fair, and transparent processes.

On taking office in 1994, Zedillo attempted to keep his campaign promise of far-reaching reform that would reduce corruption and provide Mexicans with equal access to justice. He dissolved the old Supreme Court composed of 26 justices, many of whom were either suspected of corruption or were loyal to the ruling party rather than to impartial justice. He established a new court of eleven more qualified justices, confirmed by the Senate rather than simply appointed by the executive. This new court was given unprecedented authority, both to review legislation and to adjudicate conflicts between different branches of government — the latter especially important in an era when the PRI is losing power to opposition parties at the local and state level.

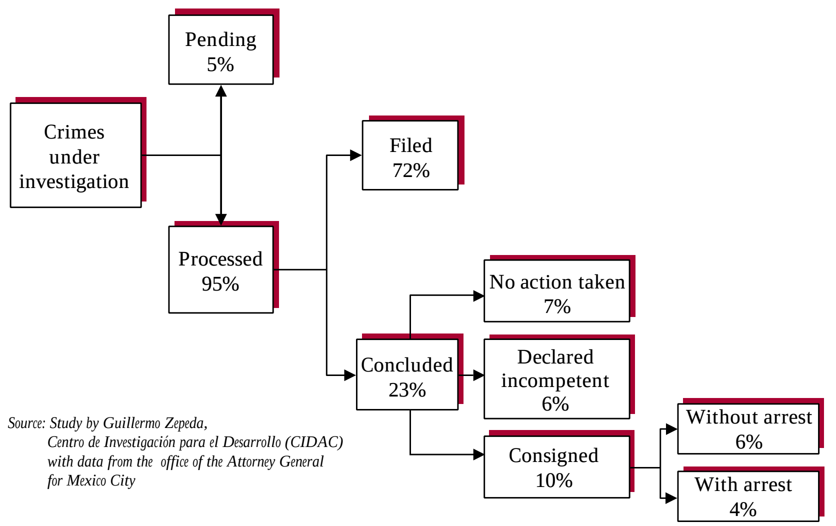
The 1994 reform gave further independence to members of the judiciary by creating a Consejo de la Judicatura to take charge of all administrative issues, thus leaving the

Supreme Court free to concentrate on constitutional questions. For the first time in 170 years, the Consejo gave the system a capacity for assessing how well justice was being administered and to monitor the performance of magistrates and judges.

Important as these changes are, very much remains to be done. The Mexican judiciary system is still plagued by financial and institutional deterioration. It lacks the funds for better salaries, enough tribunals, and well-trained lawyers. In many local courts cases are decided according to the interests of governors or local attorneys. Most states allocate only miniscule portions of their total budget to the judiciary, and so infrastructure is outdated. Modern law enforcement requires sophisticated information systems, but for want of databases and computers in Mexico, criminals walk the streets and even rise to public office — as the Cárdenas government in Mexico City learned when the media uncovered the checkered past of several of its members. Moreover, the shortage of resources also makes courts more vulnerable to bribes and to pressures from politicians who allocate their budgets.

An ineffective judiciary and unreconstructed system of criminal law cannot combat the wave of criminality that is sweeping through many of the country's major cities. In poll after poll, Mexicans rank public insecurity as one their most important concerns. In Mexico City, for example, crimes reported to the police doubled from approximately 134,000 in 1993 to 263,000 in 1997. Despite this dramatic increase, only 34 percent of arrest warrants were actually served, and only 1 in 5 sentences were imposed. One study found that of the 95 cases processed out of every 100 reported crimes, 72 are tossed out due to insufficient evidence, 23 are actually resolved, and only 4 of those 23 actually culminate in conviction and detention.

Crimes under Investigation and Prosecution in Mexico City during 1996



Source: Study by Guillermo Zepeda, Centro de Investigación para el Desarrollo (CIDAC) with data from the office of the Attorney General for Mexico City

Moreover, limited prison spaces means that when sentences are imposed, they are rarely served. Three of four criminals convicted of severe and violent crimes receive only a misdemeanor sentence and serve less than two years of jail time. Thus, the probability of conviction and serving prison time in Mexico is too remote to deter crime — no doubt part of the reason for the explosion in crime. Furthermore, the judicial system does not target organized crime, a troubling omission in light of the ability of organized crime to infiltrate and corrupt judges.

Cases of official corruption — a Morelos governor allegedly involved in a kidnapping ring, a bank president who looted his own bank — have dealt severe blows to Mexico's morale, economy, and institutions, as even people judged to be guilty have been able to elude punishment. The conviction of Raúl Salinas, former President Carlos Salinas' brother, for murdering a top PRI official — although suggesting that no one is untouchable — was hardly an unqualified success for the Mexican judicial process, for the investigation moved from tragedy to soap opera to farce. Witnesses were tortured, evidence was planted, prosecutors were indicted as accomplices, and the case became an embarrassment. Instead of redeeming the judicial system's reputation, the case further eroded it. Four years of judicial bungling left Mexicans more cynical about justice and less confident about its impartial enforcement.

This diagnosis suggests why Mexicans both criticize their judicial system and also are so skeptical about the prospects for reform. Crimes are mostly reported to Mexican authorities for insurance purposes, not with the hope that justice will be done. The incentives for thorough-going reform do not exist, due in part to entrenched interests and political fiefdoms that stand in the way. For example, civil cases might be mediated outside of formal courts, thus diminishing the demands placed on an already burdened judicial system. However, this reform is opposed by judges and attorneys who guard their privileged roles. The key players able to undertake real change thus far have lacked the political determination to do so.

Mexico's criminal, civil, and commercial codes are outdated and no longer fit the business environment. For investors, laws that are ambiguous in definition and suspect in implementation are anathema, and so foreigners resort to international arbitration to settle business claims. Foreign businesses are thus caught between seeking legal redress in the United States, which is too expensive, or in Mexico, where it is too difficult or ineffective. One result has been the emergence of professional arbitration tribunals set up by respected lawyers to decide private sector disputes — an example of "privatizing" the law when the government is considered inadequate, and one that might also spur reform by the government itself.

Multinationals have been especially hurt by the theft of goods, a phenomenon known colloquially in Mexico as *robo sobre pedido*, or made-to-order theft. Only large companies can absorb the insecurity premium — in terms of added costs and risks — to sustain operations in Mexico. These developments are damaging to a country that has prided itself for graduating to a new, post-NAFTA plateau of foreign investment. A recent survey conducted by the American Chamber of Commerce in Mexico City rated the obstacles to foreign direct investment in the following order: economic instability and insecurity; political and social instability; and the tax burden and lack of fiscal incentives. These were also the top three reasons given by companies for relocating in another country. Ultimately, reduced capital inflows and the threat of foreign capital flight may strengthen the argument for reform.

Corporate governance is another unresolved issue. Company directors in Mexico often face conflicts of interest arising from their participation in many, diverse businesses and from their close ties to government officials. These conflicts reduce the credibility of Mexican businesses vis-a-vis foreign investors, who owned over a third of the value of the Mexican stock market at the end of 1998, and in turn raise the cost of capital. Mexico needs to develop a new system of corporate governance that establishes responsibilities and penalties, and clearly defines conflict of interest. Recent efforts by a group of private business leaders to launch a set of new guidelines are a step in the right direction.

Another pending item on the legal reform agenda, one that will also affect Mexico's capacity to attract foreign investment, is how to protect the rights of preferential stock holders, bond holders, and shareholder minorities. In recent settlements with large and insolvent Mexican issuers, foreign bond-holders felt unfairly treated. The lack of a clear legal framework in this area is a vestige of authoritarian rule, when the government protected domestic businesses in exchange for tacit political support. Now, though, when domestic businesses go global and borrow in international markets, past arrangements no longer are acceptable.

As Mexico struggles to adapt old institutions to new realities, the beginnings of a debate over major reforms to, or even a replacement for, the 1917 Constitution has emerged. This debate has taken place under the wide-ranging rubric of "the reform of the state." One visible particular has been discussion, akin to that in the United States over term limits, of whether changing the Constitution to permit members of the Mexican Congress to be re-elected would enhance democracy by producing more professional legislators who better knew their constituencies, or rather would diminish it by compelling members to spend all their time raising funds for the next campaign. The constitutional debate has receded in the run-up to the 2000 elections but will resurface afterward.

THE DRIVERS OF MEXICO'S FUTURE

Mexico today is a very different country from what Mexico was twenty, fifteen, or even ten years ago. At the turn of the century, Mexico has competitive political parties, increasingly fair electoral procedures, independent media and public opinion, vibrant civic institutions, separation of powers and countervailing authority by different branches of government, considerable devolution of public authority, market-responsive and internationally competitive industries, strong pressures to respond to major regional and ethnic inequities, and broad acceptance of its fruitful integration with the United States. None of these statements were true a generation ago. Taken together they represent profound transformation.

But if Mexico's past patterns have been shattered, the shape of the new Mexico is not yet determined. No one can be sure yet how Mexico's economy, society and politics will emerge from this period of turbulent change. The central questions are whether and how Mexico will reshape its laws, institutions, and practices to meet the challenges of an open international economy, of the technological revolution, and of democratic politics.

The central questions are whether and how Mexico will reshape its laws, institutions, and practices to meet the challenges of an open international economy, of the technological revolution, and of democratic politics.

Can Mexico fashion a political system that is both responsive and effective? Can it build the basis for economic growth that is both sustained and begins to lift the boats of all Mexicans, not just those who participate directly in export sectors? Can it construct and put into practice a true rule of law, perceived as fair by Mexicans and foreigners alike? Throughout, the force of external circumstances — and in particular the impact of the United States, both indirectly through its own economic robustness and directly through the actions of its governments and its citizens — will bear heavily on Mexico's own choices.

In discussing the drivers of Mexico's future, it is useful to divide them into abroad and at home. The division is partly arbitrary but not purely so, for it does capture the relative extent to which Mexico itself can influence the drivers of its own destiny. External factors surely shape internal outcomes, and while the obverse is also true it is less forcefully so — internal factors will have only limited impact in shaping how external forces come to bear. The focus on drivers also helps sort out cause and effect, for it is always too easy to resort to generalities and to address what are really effects, not causes, results not drivers. To say that political stability is a key driver is to state the obvious, but the real questions are what is the underlying driver or drivers of that instability and how amenable are they to change?

Drivers Abroad

- U.S. economy and finance. This looms over all Mexican futures. The plain lesson of the financial problems of 1994-95 and 1997-98 is that Mexico, unique among the major emerging markets, is directly linked to the fate of the U.S. economy far more than to the "global" economy. The fate of the U.S. economy is, however, not much amenable to Mexican action. It will, to be sure, powerfully impact Mexico's choices, either to seek the benefits of globalization or to try to insulate itself from the downsides.

- Global economy. This, and developments in Europe and Japan, will affect Mexico indirectly, through effects on the United States. In particular, the structure of the global economy will affect interest rates, which have a direct impact on the cost of capital. Again, it is a driver about which Mexico cannot do much.

- Other emerging markets. Given the globalization of emerging markets, Mexico will be affected in two ways — through price competition in markets, like the United States, where it competes with imports from other emerging markets; and through effects on investors of other emerging markets to which it is perceived as similar. This driver is more susceptible to Mexican action. As global investors become more sophisticated, to the extent Mexico's economic and legal institutions are transparent, it should be possible to insulate itself from financial panics elsewhere.

- Oil prices. Mexico, while not a member of OPEC, played a role in moving oil prices upward when it agreed, in 1998, to cut production along with Saudi Arabia and Venezuela. It could also try to act on the cost side, by dramatically increasing foreign investment to drive its high costs down; its productivity in the oil sector is among the world's worst. Despite recent increases, the downward pressures on oil prices are evident. Given sunk costs, fields do not come out of production as prices fall, the steady creep of technologies is lowering the price at which alternatives come on line, and the cost of liquified natural gas, about $24 per barrel, provides an effective cap on prices.

- U.S. policy. This seems a powerful driver, in both direct and less obvious ways, and it is one over which Mexico has some influence. For instance, NAFTA came into being in part because Mexico lobbied Washington hard for it, and it could mount similar efforts for causes it considered important. How the U.S. Treasury reacts to Mexican policy, and how much it rallies international financiers, is one direct effect. So, too, might be major changes in U.S. drug or immigration policies, for good or ill. Yet the "United States" also affects Mexico in a host of less direct ways — from what federal officials say or do, to similar actions by state and local officials, to decisions about investments by U.S. corporations or about priorities by U.S. NGOs.

- Mexicans and Mexican-Americans in the United States. These will play a larger and larger role. Economically, remittances are marginal to Mexico City but important to states such as Guanajuato, Michoacan, and Puebla. More important, easier communication is making it possible for emigrants to stay close to their home communities. The growth of the immigrant population and the importance of its economic contributions help explain why Mexican officials and political candidates have assiduously courted Mexican constituencies in the U.S. since 1988. Mexicans in the United States will not be allowed to vote in the 2000 presidential election but still will be important in the campaign.

Drivers at Home

These are arrayed more or less in order of increasing reach into the future:

- 2000 elections. This is more an indicator than a driver, for it will suggest the state of leadership and the nature of the body politic's reaction to the end of the Zedillo presidency and of the dominant-party state. Both how the election is conducted and its result will then become drivers of the future.

- Economic policy. Here, the indicators will be, for the macroeconomy, fiscal, monetary and exchange rate policy, which will then affect budget deficits, inflation, and growth rates. For the microeconomy, it will be important to watch whether the processes of liberalizing, deregulating, and privatizing are continued, accelerated, delayed, or abandoned. One indicator will be how important the debate over the economic model becomes. Some specific choices, like whether to dollarize the economy, will directly bear on Mexico's economic future.

- Political, institutional, and social reform. This includes a host of indicators, some quite short term like the form of PRI candidate selection or the state of electoral watchdogs. It ranges through the nature of the parties to the role of Congress. The critical signposts in the process will be visible efforts to establish a rule of law through reforms of the Constitution and the judiciary, along with increased spending on the judiciary and penal systems. Over the longer run, the state of education is critical, as is Mexico's capacity to keep up with the technological changes that are reshaping the world economy. And ultimately there are changes related to major Constitutional changes, in energy for instance, that would touch the treasured icons of the revolution which may now be mismatched to governance and the provision of public services in a globalized world.

- Regional disparities and political decentralization. The dominant long-run fact about Mexico is its North-South cleavage. How that plays out will be critical, for it is intertwined with issues of social justice. Will the gap become a tolerable divide or an open sore? Indicators to watch are statistics on poverty, education, and other social factors, along with the progress of the anti-government guerrillas. The politics of decentralization are entwined with the north-south divide, though not always in direct ways. For instance, autonomy unaccompanied by generosity would merely leave the South on its own, to be governed by traditional barons or ungoverned by violence.

- Impact of new actors. These range from the media, to the army and NGOs, to drug dealers, criminals, and rural rebels. Mexican society and politics are opening in all sorts of ways for which there are no precedents (and for which U.S. experience may mislead). For instance, the Mexican press is now quite free of government influence; whether it goes from free of influence to free of content is not yet sure. Will crime and drug trafficking continue to be nasty background factors, or will they become political forces either in the backlash against them or because traffickers seep into politics? For the last half century, the Mexican army has been a humble servant of its civilian masters and nowhere near as important politically as its counterparts in Latin America. Will crime, drugs, and political instability change that?

MEXICO'S FUTURE: IMPLICATIONS FOR THE UNITED STATES

This is a report about Mexico's future, not that of the United States. But Mexico's future will have a large impact on the United States, and vice versa. For both countries, the other is now virtually a domestic issue. The agenda for the next decade — trade, investment and the treatment of investors, labor standards, the environment, immigration, narcotics, border issues, and human rights — respects no tidy distinction between foreign and domestic, between at home and abroad.

NAFTA and economic integration have abetted this trend. So have the strengthening of democracy and civil society in Mexico. In embracing NAFTA, both countries, but especially Mexico, made bets of historic proportions. Mexico decided that since it was condemned to be, in the Mexican saying, so far from God but so close to the United States, it would seek the benefits of real partnership, not hold onto a reserved autonomy. The United States decided, less explicitly and perhaps less consciously, that more direct engagement with Mexico would be both an economic boon and, in the long run, the best way to manage the pressures for Mexican migration northward.

A plethora of new political actors are becoming vocal participants in the bilateral connection. New ties between citizens of the two have developed outside the scope of government-to-government policies. New actors include state, municipal, and local governments; political parties other than the PRI; the military and other armed forces; the business sector; national and international NGOs; and Mexican media that are more independent, investigative, critical, and consumer-oriented. These actors are key drivers of Mexico's transitions. They will also contribute to a more complicated and intense, yet also a richer and more transparent, set of ties to the United States.

But Mexico's future will have a large impact on the United States, and vice versa. For both countries, the other is now virtually a domestic issue.

Mexico's economic and political transformations, its insertion into the world economy, its acceptance of free market economics, and the convergence of economic and political models between the two: all these present stunning challenges to citizens of both countries. For the United States, Mexico is now much more than simply a problematic neighbor. For Mexico, the United States is no longer only to be envied, sometimes hated. It can now be worked with openly, even emulated. For both, interdependence, however asymmetric, is a fact, if not always a fully welcome one.

Yet despite their thickening connections, Mexico and the United States are still vastly different countries. Mexico is relatively poorer, increasingly competitive, and immensely proud. Its per capita GNP is still only about a seventh that of the United States, yet its population is growing twice as fast, so the pressure of population flows will continue no matter how well NAFTA succeeds. It still rankles Mexicans when the United States challenges Mexican sovereignty, usually around issues of narcotics and immigration.

A new bilateral road map would begin with the understanding that NAFTA is only part of a much broader, richer, and older U.S.-Mexico relationship. Because Mexico will continue to change rapidly, to deal effectively with it, governments at all levels as well as private actors in the United States need to understand better and act more intelligently with regard to Mexico's simultaneous political, economic, and social transitions.

Because Mexico will continue to change rapidly, to deal effectively with it, governments at all levels as well as private actors in the United States need to understand better and act more intelligently with regard to Mexico's simultaneous political, economic, and social transitions.

The first challenge is dealing with a constrained Mexican presidency, a more plural Mexican Congress, and a continuing decentralization of power and decision-making to the state and local levels of government. The reshaped presidency is perhaps the most important — how to cope with the loss of predictability provided by Mexican presidents who completely dominated their system. From the White House on down, the U.S. government and American interest groups, including corporations, must learn to do business in a more turbulent and less predictable environment, at least for the near future. Key assumptions, like the dominance of the PRI, will no longer hold, and it will be necessary for the first time, for example, to treat Mexico's opposition parties as relevant actors.

So, too, the Mexican Congress will have to be taken seriously by U.S. counterparts, and Washington will have to recognize their role as a check on the executive. Washington and Mexico City will be less and less able to sustain their long monopoly on the official bilateral relations. Treaties and negotiations will have to be conducted more openly, with more legislative scrutiny. In the past, Mexican members of Congress, controlled by the PRI, were routinely silent on the United States and bilateral relations, but no longer. State and local authorities from both countries will interact directly, without the support and sometimes the knowledge of the nations' capitals. These authorities, too, will need to be taken into account as they become more significant.

Finally, the strengthened role of Mexican civil society — including activism by non-governmental organizations and a more critical and investigative media — poses both opportunities and risks. Although the traditional Mexican "rules of silence" have given way to open criticism at home, Mexicans will continue to be sensitive to what they perceive as U.S. intervention in domestic affairs. Surely, the interests of U.S. citizens cannot let them remain silent — witness international activism in Chiapas. But Mexican nationalism still prevails, and Mexican society remains sensitive to U.S. pressure. How U.S. citizens speak and act while recognizing Mexican concerns for sovereignty, and how Mexicans redefine what is meddling: these remain open questions.

A second challenge is making the most of economic integration. Although Mexico still depends more on the United States than vice versa, Mexico is becoming more and more a part of America's everyday life. Free trade is about more than tariffs, and a more truly level playing field for market access will challenge national authorities dealing with antitrust, regulation, and other matters to ensure that the "two-way" nature of NAFTA principles is not threatened. So, too, while the existing NAFTA dispute settlement provisions, together with the pragmatism of both countries, have avoided major confrontations over trade and investments, Mexico needs a "special mechanism" on the model of U.S. arrangements with Canada and Japan.

Neither Mexico nor the United States is ready for dollarization or a currency union. Instead, Mexico might try to make its major economic indices such as inflation, debt service, and government and current account deficits converge with those of its main trading partners, the United States and Canada, without necessarily committing to dollarization at the end of the process. This convergence occurred fairly successfully in Europe from the signing of the Treaty of Maastricht in 1991 to the adoption of the Euro at the beginning of 1999.

New initiatives will be required to engage the private sector in both countries in a broad range of hemispheric tasks, promoting industrial clusters and expanding the benefits of the maquiladoras beyond northern Mexico; supporting small and medium businesses; encouraging both Mexican and U.S. businesses to be effective catalysts for Mexican job creation and technological advance; developing infrastructure in the context of North American integration; and improving corporate governance in Mexico.

The third and thorniest challenge is dealing with social issues across the border. The demographic realities between the two countries mean a rapidly growing Latino population in the United States. Moreover, the great majority of new immigrants indicate that they intend to make the United States their permanent home. During the first quarter of the next century, the white, Anglo majority will become a minority in much of the U.S. southwest, and Latinos will replace African-Americans as the largest minority group in the country. At the same time, Mexican immigrants are strengthening their linkages to their places of origin through more frequent visits and calls, and through the growth of hometown associations that enable them to participate in the traditional celebrations of their native communities and also recreate those holidays in the United States.

Not only will Mexicans in the United States play an increasing role in Mexico's future, the empowerment of the Mexican-American community — and the growth of the Mexican national population in the United States — will bring to the fore challenges to education, welfare, health care, employment, and cultural preservation; all are issues at the root of American success as a nation and people.

Fair weather economically in the United States today offers a window of opportunity for redefining the issue of people flows in a less confrontational way. In 1998, for instance, there were nearly 200 million legal crossings from Mexico into the United States, and most were shopping trips. These shoppers paid sales tax on their purchases, providing U.S. cities, counties and states with a tax windfall of approximately $2 billion from people to whom they provided almost no services. It is important to curb the influx of illegal immigrants and to reduce the estimated $250 million a year that local U.S. governments spend on them, but the beneficial impact of Mexicans who cross the border should not be overlooked.

There is a chance to separate fact from fiction, for Mexican immigration has been a boon to the United States, though it is not seen that way by every American citizen. In the flourishing American economy, firms in the service and agricultural sectors face labor shortages. From the Mexican perspective, legal migrants could benefit from more secure and better supervised working conditions, through, for example, a new system of temporary U.S. visas. What is required is not just a more detailed binational dialogue on immigration, but also a recognition that the social issues surrounding migrants also affect those poorer Americans already residing in the United States. They need attention in their own right; immigration only sharpens that need.

Finally, drugs remain the biggest irritant in the bilateral relationship. In the last five years the two governments have created a substantial number of institutions — including a bilateral planning commission — and mapped out a detailed plan of action to combat drug-trafficking. Yet despite good intentions and some accomplishments, these initiatives have made little dent on a booming business. As long as the United States remains a large and lucrative market for illegal substances, Mexico's close proximity assures that drug-trafficking will continue to plague relations between the two countries. In the long term, a truly binational and cooperative policy is the most effective way to address the drug problem. There simply are no unilateral solutions, and attempts to shape them, such as the U.S. "certification" process for countries like Mexico, poison the atmosphere for international cooperation.

Mexico's future, however it evolves, will have a significant impact on the United States, and especially on California and the other western states. The economics, demography, politics, and culture of the American west will be in significant measure conditioned by how Mexico fares. How western-based corporations, unions, government agencies, non-governmental actors, the media, and plain citizens act in and toward Mexico, in turn, will be among the important factors shaping Mexico's course.

Ultimately the success of Mexico and the United States at managing and enhancing their shared destiny will depend on the quality of decisions, dialogue and mutual understanding between the two societies. It is in that spirit that we offer this report.

PERSONAL COMMENTS

Cresencio Arcos: "Another problem is Mexico's inability to attain a fully credible competition policy. A recent OECD report details that in telecommunications the biggest private company (and former public monopoly) in Mexico, continues to enjoy flagrant regulatory bias. In fact the sector regulatory entity (COFETEL) has openly disregarded the Federal Competition Commission's rulings that this private monopoly be regulated as a dominant player in the market. This anti-competitive finding was an attempt to protect fledgling competitors. A transparent and fair public policy rule-making process is indispensable to attract direct foreign investment."

Juan Enríquez: "We have to ask why, despite highly qualified government servants and decades of reforms, privatization, and growing exports, most Mexicans are poorer. Two key reasons include a low investment in human capital and a lack of technology entrepreneurs. The government is spending less on its citizens and more on debt service and bailouts. This is disastrous in the long term because a knowledge-driven global economy places an ever decreasing value on most raw goods and assembly manufacturing. While most of the world's new crop of billionaires is involved in high tech endeavors, many of Mexico's wealthiest come from government granted oligopolies or from a privatization of government assets. Furthermore, almost all growth in manufacturing employment has depended on providing cheap labor in enclaves where most government regulations are obviated (maquiladoras).

This means most value added depends on assembly, not on knowledge protected by international patents or copyrights. Mexicans who are technologically competitive on a global scale are increasingly living abroad, working for foreign corporations, or living in a very few cities, particularly Monterrey. In a world where the processing power of a computer is doubling every eighteen months and its cost is being cut in half, Mexico risks falling much farther behind. Wealth depends on research and development, something that is increasingly absent from a daily debate focused on FOBAPROA, security, political reform, natural disasters, and corruption."

Richard Feinberg: "U.S.-Mexican relations obey the 'law of the affirmative agenda.' If policy makers fail to occupy center stage with a cogent vision and positive initiatives, negative tensions will fill the policy vacuum. In 2001, the new U.S. and Mexican presidents could boldly expand on the NAFTA trade agreement to outline complementary regimes to govern the movements of capital and labor. This Report, albeit timidly, sketches possible future directions for such historic understandings. The logic of increasingly broad and deep North American integration drives in the direction of gradual monetary integration and carefully crafted legal frameworks to govern labor flows."

Mario Rodríguez Montero: "The high cost of capital is one of Mexico's most difficult and central problems, for it slows growth and exacerbates inequalities and social injustice. Full dollarization will help Mexico confront this problem, and should be achieved within the next five years."

We gratefully acknowledge those who provided support for this Mexico Study Group, as well as other sponsors of the Pacific Council.

Sponsors of the Mexico Study Group

Anheuser-Busch Companies
AT&T
California Commerce Bank
Chrysler Corporation Fund
Coutts & Company
Ford Foundation
GE Capital
General Service Foundation
Conrad N. Hilton Foundation
Shell Oil Company

Founding Corporate Sponsors

American International Group, Inc.
ARCO
AT&T
Bank of America
The Boeing Company
Burson-Marsteller
California Community Foundation
The Capital Group
Chase Manhattan Bank
Deloitte & Touche LLP
The Walt Disney Company
Edison International
First Interstate Bank of California
Hughes Electronics
IBM
J.P. Morgan Co., Incorporated
Kaufman & Broad Home Corporation
Merrill Lynch & Co., Inc.
Microsoft Corporation
Pacific Enterprises/Sempra Energy
QUALCOMM, Inc.
Skadden, Arps, Slate, Meagher & Flom
The Times Mirror Company
Univision
Warner Bros.

International Corporate Sponsors

Asahi Breweries, Ltd.
Banamex/California Commerce Bank
Grupo CYDSA
Grupo Modelo
Pulsar International
Techint
Telmex

Corporate and Institutional Benefactors

Libellule Enterprises
Payden & Rygel
Public Policy Institute of California
Rose & Kindel
The Wine Institute of California
Titan Industrial

PACIFIC COUNCIL ON INTERNATIONAL POLICY
LOS ANGELES, CA 90089-0035
TEL: (213) 740-4296
FAX: (213) 740-9498
E-MAIL: PCIP@USC.EDU