

## MEXICO 2012: TRACKING DEMOCRACY IN A TIME OF UNCERTAINTY



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### Mexico's 2012 Presidential Election and U.S.-Mexico Relations

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The U.S.-Mexico bilateral relationship in recent months has been plagued by a series of highly sensitive issues. In December, Wikileaks postings revealed U.S. embassy dispatches critical of Mexico's war on drug cartels and characterizing prospective presidential candidates from the National Action Party as weak. That led to a breakdown of trust between U.S. ambassador Carlos Pascual and Mexican president Felipe Calderón. Then came the murder of U.S. Immigration and Customs Enforcement agent Jaime Zapata by drug cartels, just prior to Calderón's trip to Washington to discuss bilateral relations with U.S. president Barack Obama. On the heels of the trip came Operation Fast and Furious, a U.S. Bureau of Alcohol, Tobacco, and Firearms sting that allegedly misdirected some 1,700 weapons to Mexican traffickers.

Despite such high-profile setbacks, the U.S.-Mexico relationship will soldier on thanks to the desires on both sides of the Rio Grande to advance cooperation that began two decades ago with the North American Free Trade Agreement (NAFTA). Now, security, economic stability, and energy cooperation are themes likely to emerge in the 2012 Mexican presidential campaign season. Although it is still early to identify clear party or candidate positions regarding them, it may be safe to say that a National Action Party (PAN) victory would probably leave these areas little changed if not enhanced, whereas a Democratic Revolutionary Party (PRD) win would probably roll them back. The impact of an Institutional Revolutionary Party (PRI) triumph is difficult to predict as the party was instrumental in improving economic cooperation, even as the old PRI prided itself on prickly relations with the United States.

#### **Security**

This is *the* issue where Washington will increasingly focus its attention as the election nears. The impressive advances made in bilateral security cooperation during the Calderón administration have been hailed as a high point in U.S.-Mexico relations. The Mérida Initiative is but the most

visible manifestation of this cooperation; of more long-term significance are the high levels of interagency cooperation on the drugs issue, unprecedented exchanges of information, and much deeper understanding between individuals and government offices on both sides of the border. In part these advances in understanding are what make the breakdown in communication in the Pascual affair all the more intriguing. More importantly, however, a significant change in priorities with regards to Mexican security issues by the next administration threatens to undo much of what has been achieved since 2006.

Beginning with the PRD, the two main contenders offer quite different prospects. Andrés Manuel López Obrador, the losing candidate from 2006, would almost certainly rapidly withdraw his support for intense bilateral cooperation with the United States. Marcelo Ebrard, the other leading contender for the PRD candidacy, would likely reduce the most visible forms of cooperation with U.S. authorities, although without the visceral reaction that can be expected from López Obrador. Either way, a PRD victory in 2012 will probably signal a fundamental change in the basis of information exchange, interagency cooperation, and the probability of securing another accord like Mérida.

The PAN, on the other hand, is most likely to continue to work closely with the United States on the drugs issue. None of the probable PAN candidates will likely be as enthusiastic as President Calderón over bilateral security cooperation. However, each of the leading contenders has recognized the benefits of working with the United States. The big question with the PAN, rather, lies in the approach that will be taken with regards to drug trafficking organizations (DTOs). The Mexican public, and many among the political and business elites, believe that the current strategy of direct confrontation with the DTOs has failed. Josefina Vazquez Mota, self-declared contender for the PAN nomination, former social development minister, and the woman who ran Calderón's successful election campaign in 2006, has argued recently that any Mexican government cannot contemplate making a deal with the DTOs; but there seems

to be little willingness among PAN leaders to risk political capital by publicly committing to the current administration's strategy.

The PRI, as ever, remains somewhat of an enigma. Enrique Peña Nieto, the runaway leader for the party's nomination until now, has commented that he would continue the fight against the DTOs, but using different means. No one is quite sure what this means, although most experts speculate that Peña Nieto would likely back away from the direct confrontation strategy employed by Calderón. What remains unknown is whether a PRI president in Los Pinos would continue security cooperation with the United States. In the past, PRI presidents have used an anti-U.S. rhetoric while maintaining close cooperation with the northern neighbor behind the scenes. It may be that Mexico will return to this kind of "below the radar" security cooperation if Peña Nieto wins in 2012.

Overall then, one might expect a change of direction in security strategies after July 2012, no matter who wins the Mexican presidency. This should alert U.S. policymakers to the need to engage the leading contenders on security cooperation earlier rather than later with a view to understanding their positions and influencing their approaches.

### **The Mexican Economy**

Despite the deep recession of 2009, during which the economy shrunk by 6.5 percent, Mexico is now immersed in a rapid and sustained recovery. The importance of a healthy Mexican economy for U.S. competitiveness has once again become clear, as American producers have begun to relocate manufacturing capacity from China to northern Mexico, a decision based on the relatively low valuation of the peso, rising wages in China, and the need for "just-in-time" production for businesses in a recovering U.S. market that do not want to hold large inventories. As Mexico's investment and trade prospects improve, it is vital to recognize that wise macroeconomic management and fiscally conservative policies by the Calderón administration saved the country from a much deeper and more prolonged recession. In fact, despite the fact that Mexican economic growth has been somewhat disappointing over the past 11 years, it is undeniable that successive PANista governments have been successful in bringing higher levels of stability to the country and preparing the way for long-term prosperity. But what about the potential successors to the Calderón administration?

The PRD offers the prospect of the most fundamental change in direction in this area. López Obrador, based on his election platform of 2006, would be the most likely to

engage in much higher levels of federal government spending by improving social programs, raising wages, and increasing subsidies for Mexican producers. At the same time, tax hikes for the upper middle and upper socioeconomic classes might be forthcoming in an attempt to address the question of social justice and to try to cover the fiscal gap created by higher spending. We should expect a similar but more moderate program from Marcelo Ebrard. What is intriguing about these two left-wing contenders is that they can both call on the successful experience of managing Mexico City's finances during their respective terms as mayor. During their terms, both men engaged in heavy infrastructure spending, borrowed large sums from capital markets, and brought comparatively high levels of economic growth to the Federal District.

The contenders for the PAN candidacy, on the other hand, would likely follow the Calderón administration's lead in terms of fiscally conservative behavior. The heavy influence of ITAM-trained economists in the upper echelons of the party means that a shift to high levels of deficit spending is improbable. More compelling is the question of whether a future PAN president would continue to push the Mexican economy toward higher levels of competition by attacking the monopolistic and oligopolistic stranglehold of a small number of firms. The Calderón administration has made a series of regulatory-level attempts to take on the dominant monopolies in the communications industry, by opening up new bandwidths and by offering alternative networks through the state-run electricity company, CFE. As we approach the end of this administration, however, the Mexican economy is still controlled by a small number of firms and a small number of powerful families. It is also likely that a PAN president would continue with the present government's conservative approaches to currency management and inflation, meaning that Mexican economic growth would be likely to remain steady, but not spectacular.

The PRI as a party has come a long way with regard to economic policy from its period of hegemonic control of the country. Indeed, it was under Presidents Carlos Salinas de Gortari and Ernesto Zedillo that the real modernization of the Mexican economy began. There is now a greater understanding within the party of the need to integrate Mexico more completely into the global economy, to expand trade relations, and to provide for sound monetary management. On other issues, however, the PRI still holds to its former ideals. On competition policy for example, the party has shown little willingness to take on the monopolies. On labor reform, its proposals currently before the Mexican Congress are far less ambitious in terms of increasing labor market flexibility than those put forward by the PAN late

last year. And on fiscal reform, the PRI has held back the PAN in its efforts to diversify the Mexican government's tax base away from PEMEX and to increase the overall tax take.

The questions surrounding economic growth and stability after July 2012 are of vital importance when we consider the interdependence of the U.S. and Mexican economies, when we consider how U.S. competitiveness increasingly depends on the integrated production networks of the NAFTA region in general, and when we consider the impact of either low or high economic growth on the migration of Mexicans toward the north. On this last point it would be tempting to believe that a populist economic program that created massive employment in the short term might bring beneficial results. The danger, of course, is that such an approach will bring on a crisis in the medium term as the government becomes more heavily indebted and the peso becomes overvalued. The impact of a deep and sudden economic crisis could be reflected immediately in the form of massive migration from depressed areas of Mexico to the United States.

### Energy

One of Mexico's most important remaining economic challenges lies in the oil sector. As is by now well known, PEMEX has been suffering over the past four years from rapidly declining reserves and production, with recent discoveries only serving to stabilize the decline. Though a majority of energy experts in Mexico has long argued that what is needed is an opening of the oil sector to private investment, the Mexican political elites have thus far been unwilling to contemplate such a radical reform, one that would necessitate a constitutional change. In 2008, the Calderón administration attempted to bring about a wholesale reform of the oil sector in Mexico, but in the end only achieved piecemeal changes after its efforts were stymied by negotiation with the opposition parties in the Congress. PEMEX as a company lacks the technology and know-how to get to oil reserves in the deepest waters of the Gulf of Mexico, where it is thought that up to 30 billion barrels may remain. Without technology and expertise from private partners, PEMEX has been forced to concentrate on on-shore and shallow-water production. As those reserves and production decline, and as national demand increases, Mexico could become a net oil importer by the end of this decade. This will be a major challenge to the fiscal and economic strategies of any future president. So what are the prospects for a return to energy reform after the election of 2012?

The PRD is the least likely of all three parties to propose meaningful reform of the energy sector. Having protested vehemently against even the partial reforms of 2008, the

party maintains its commitment to keeping private investment (both foreign and national) out of the sector and has invested in building up support from the PEMEX union, which is itself strongly opposed to such a change. Although López Obrador himself contemplated a role for the private sector in oil production prior to the election of 2006, he has since moved firmly away from that position. One minor point of interest is to consider what a Marcelo Ebrard victory in the polls might mean for energy policy. Less fundamentally opposed to opening up the oil sector and firmly committed to climate change mitigation strategies, he could well contemplate further progressive changes to PEMEX and bring about increased investment in the renewable energy sector.

A PAN president would likely try again to get far-reaching reform of the oil sector. Building on the changes made to PEMEX after 2012, and especially the authorization of incentive-based contracts for private oil companies that has occurred in 2011, a PANista in Los Pinos would most likely push for an opening up of the sector, to allow for joint exploration and production between PEMEX and private or foreign oil companies. To allow this, an amendment to the Mexican Constitution (Article 27) will be required. To ease the passage of such an amendment, the most likely scenario would be to suggest joint ventures between PEMEX and foreign national oil companies (NOCs), such as Petrobras, that have expertise in deep-water exploration.

The PRI is once again the most intriguing of the three options. It is probably the best equipped of the parties in the sense of its ability to tackle the PEMEX union, it is the most likely to control Congress (fundamental if a constitutional change is to take place), and it has the broadest base of support among state governors (also a necessary requirement for constitutional reform). Yet the PRI also has hard-line groups within it who continue to resist any increased flexibility in terms of private participation in the sector. The dinosaurs in the party still believe that the oil sector must remain in the hands of the Mexican government, and that view is supported by a majority in public opinion polls. Having said this, a PRI president would be forced to recognize the dire implications of further decline in the oil sector, both for government finances and for the economy in general, and would likely move to a more pragmatic position that allows for a partial opening in the sector.

### Final Thoughts

These speculations about the future are based on past history, prevailing opinions, and likely economic and political scenarios. So much could change in any one of the three issue areas discussed above that it is difficult to make clear

predictions at this time. One factor that will be of crucial importance is of course the outcome of elections for the Mexican Congress next year. If the Mexican electorate decides to split its vote between president and Congress (as it has done since 1997), then any president will face serious challenges in getting his or her policies accepted by the legislative branch. In that sense the PRI may provide the best hope for progress, as it is the only party that seems to have the chance of winning both Los Pinos and both houses of Congress. Twelve months from now we will revisit these same issues and comment on the potential for change once the candidates and parties have defined their positions more clearly.

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