

Washington's Potential Mexico Problem

BY CHRISTOPHER WHALEN

The consequences of a left-wing win in July's elections could be greater than financial markets think.

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“Mexicans don't need any lessons from Hugo Chavez in Venezuela about being socialists,” groused an official of the Fox government when asked about the prospect of a left-wing win in Mexico's July presidential election. “When Andrés Manuel López Obrador wins power,” says the same source, “the period of stability in Mexico will be over.”

Over the past six years, foreign investors and political leaders have become accustomed to stability, even torpor, in Mexico's once volatile political economy. The government of Vicente Fox Quesada, who nominally represents Mexico's conservative PAN party, has avoided the assassinations and scandals of his predecessors, albeit while accomplishing almost nothing in terms of structural reforms of Mexico's exquisitely corrupt gov-

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A leading contender in Mexico's upcoming presidential elections, **Andrés Manuel López Obrador** is known as "AMLO." If AMLO follows through with only half of the promises he has made along the road to the Mexican presidency, his nation's hard-won achievements in areas such as inflation and political stability could become memories.

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lost the opportunity for change. The corrupt institutional interests of Mexico's political parties and the government bureaucracy then effectively stifled any chance for transformation." Showing more than a little bitterness that these same institutional interests blocked his presidential candidacy, Castañeda laments the lack of movement in areas such as the judiciary and police corruption.

Despite the lack of progress by Fox during his six-year term, as the July elections approach the situation in Mexico is viewed by foreign investors with almost total equanimity. The prospect of López Obrador, who is known as "AMLO," gaining power in Mexico is greeted as an inevitable swing in the political pendulum south of the border, part of a regional lurch to the left that has seen socialist, anti-U.S. governments take power in Brazil, Venezuela, and Peru. Mexico represents the latest and most significant event in this trend line, but this is an event that Wall Street has largely ignored.

Walter Molano, a keen observer of the Latin scene and partner in BCP Securities in Greenwich, argues that whatever government comes after Fox is not going to have a great deal of flexibility in terms of economic policy. "The election of AMLO will provide a test in terms of economic direction," says Molano, who believes that some observers are going to attempt to demonize AMLO as being somehow "dangerous" to the United States, a view he finds ridiculous.

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erning institutions. More important for Washington, Fox has been reliably pro-United States even when the Bush Administration has treated him with indifference and contempt.

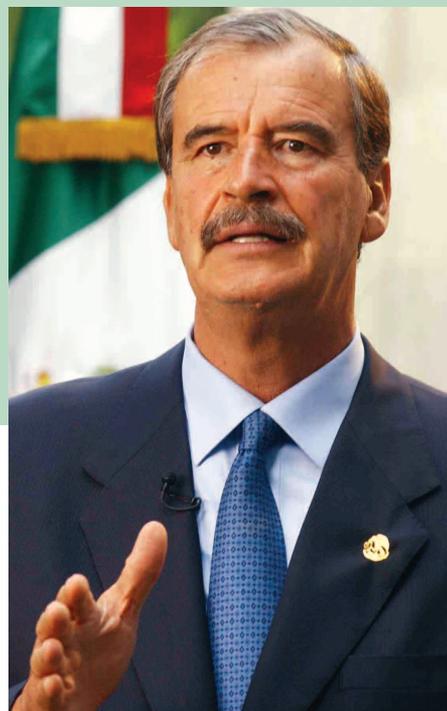
So successful has Fox been at avoiding destabilizing events that Washington has basically been able to forget about Mexico. The once-double digit risk premium seen in Mexican debt and currency markets has almost disappeared. Consumers south of the border can obtain fifteen-year peso mortgages with interest rates in single digits, while consumer financing for autos and household appliances is likewise plentiful. Mexicans, it seems, are also beneficiaries of the easy-money policies of the U.S. Federal Reserve under Alan Greenspan from 2000 to 2004.

"Fox has proven to be a decent administrator, especially compared with past governments," argues Jorge Castañeda, the controversial writer and former foreign minister who waged an unsuccessful campaign to start a new political party after his resignation in 2003. "There has been no crisis, no repression, no assassinations or devaluations," says Castañeda, who admits that key goals such as raising economic growth above 3 percent and structural reforms went by the wayside early in the Fox sexenio, or six-year term.

"Vicente was unable to articulate a path to reform," says Castañeda. "He could not tell the people why institutional change was needed or how it would benefit them. As a result, Fox very early on

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“The good news is that the PRI is continuing to disintegrate and that Mexico is going to go through another peaceful transition of power,” says Molano. “It is time to give the left a chance to rule. One group of crooks will be kicked out and a new group come in. Will the new crooks steal less than the old crooks? We’ll see.” Like many economists and investors, Molano believes that the structural changes made in Mexico over the past decade are permanent.

While not concerned with the prospect of political radicalism in Mexico, Molano does see chances for mischief, especially in areas such as trade and energy. He points to the effort by the Chavez government in Venezuela to link its oil pipeline infrastructure to that of Colombia, an effort that should allow Venezuela to begin significant oil shipments to Asia within two years. A vocally nationalist government in Mexico will be right at home with the anti-U.S. diatribes of Hugo Chavez and Ollanta Humala in Peru, both of whom benefit from the continued low economic growth rates in many parts of the region.

Molano argues that as China has come to dominate industrial activity, Latin America is in the midst of a deindustrialization as the region focuses on its areas of comparative advantage. “Although hundreds of thousands of manufacturing jobs were lost,” Molano writes about the shift in manufacturing to

Asia, “millions of new jobs in commodity-related sectors appeared. The unemployment rate across the region is declining as workers move into agriculture, mining, and energy. Moreover, jobs in high-margin commodity-related sectors are proliferating. Agronomists and agro-engineers are in hot demand in Argentina and Brazil. The crop-dusting business in Brazil is booming.”

Regarding the prospect for a new, left-wing government in Mexico City, Molano says that expectations are so low following six very predictable years of Fox that AMLO will seem a fount of ideas and activity by comparison. If AMLO also begins to focus more attention and resources on trading partners like China and India, Washington’s ability to influence policy in Mexico City may wane. This process is already underway as Mexican officials and business leaders stream to Asia in search of markets and investment.

“The Chinese and Indians have been surprisingly flexible with Mexico,” argues Molano, who points out that both nations have worked hard to find internal markets for Mexico’s exports, unlike the arrogant indifference emanating from Washington. “Russia’s decision to construct new pipelines to China and Venezuela’s decision to build a pipeline to the Pacific are responses to the fundamental shift in the global economic order. Governments in the region are

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increasingly looking to Asia, not Washington, for their future growth.”

With AMLO seemingly headed for the presidency and some observers even predicting that Mexico’s left-wing PRD party will control the country’s lower house, the scene seems set for a shock to the global financial markets, even if some of the dire political predictions regarding AMLO turn out to be overstated. A Mexico that pursues its own best economic and political interests may not be the same Mexico that the Bush Administration has taken for granted over the past six years.

“López Obrador was born on November 13, 1953, in the southern Mexican State of Tabasco, an oil-rich location with abundant natural resources,” according to his biography. He was a member of the PRI until the 1980s, when a loss in the internal selection process for PRI governor drove him into the political wilderness with other disaffected Priistas like Cuauhtémoc Cárdenas Solórzano.

During the 1990s, AMLO twice stood unsuccessfully for the governorship of Tabasco and then moved to Mexico City, where he became a leader in the PRD as it challenged the dictatorship of Carlos Salinas de Gortari. This writer served as a speechwriter for Cardenas in the 1994 presidential campaign and saw firsthand the murders, beatings, and other acts of intimidation committed against members of the PRD. While foreign investors, political leaders, and journalists lionized Salinas as a “neoliberal,” in Mexico over two hundred PRD militantes were murdered during his rule.

In 2000, AMLO won the mayor’s office in Mexico City by less than one percent of the vote, thus

becoming the boss over one of the largest political entities in the world. From that platform, AMLO began a transition to national power that has seen him and other members of the PRD become more and more like their counterparts in the PRI. AMLO talks in the populist language of the left, but he has the habits of a wealthy man with luxurious homes, chauffeur-driven cars, and the other outward signs of wealth that distinguish Mexico’s political class from everyone else.

As Castañeda reminded *TIE* in April: “Mexico’s political party system is entirely corrupt. The parties are interchangeable and really only stand for obtaining power. This is why all three parties and the Mexican government fought my bid to start an independent party. Even a marginal candidate in a truly independent party would catch on like wildfire.”

Castañeda, who is himself a member of that same privileged, largely European political elite, believes that foreign observers are not prepared for the type of strong, independent political line that AMLO is likely to take as president. “AMLO is Echeverría, not Hugo Chávez,” argues Castañeda. “He is a traditional Mexican populist, not a radical like a Chávez or Humala. AMLO likes to spend money and build big projects, but he hates the Congress and democratic political processes, and notions like an independent central bank. He portrays himself as a strong leader who will deliver growth and jobs, but he will do this by stigmatizing the wealthy and increasing subsidies to the poor.”

The picture of AMLO painted by Castañeda and other critics is of a man who is prone to hyperbole and obfuscation, and not a little anti-gringo semantics.

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Barnard R. Thompson wrote in 2004 about the various scandals swirling around AMLO: “It would be hard however to claim no smoking gun when nearly US\$2 million is missing from the Mexico City treasury and there are video recordings of AMLO’s finance chief gambling it away in Las Vegas, videos that were broadcast on Mexico’s national news. Too, it would be difficult to deny that an AMLO kitchen cabinet insider was taking bribe money when the whole thing was caught on tape, another video that was shown worldwide.”

Barnard continues: “But AMLO, rather than confront the problems and ferret out the real culprits, yelled bloody murder as he blamed, and continues to blame, anyone and everyone—including a number of U.S. entities—for plotting against him. As such, AMLO has proved to be a conspiracy theorist extraordinaire, however he has failed to produce promised evidence and proof each time he has vowed to do so.”

Indeed, AMLO has already made clear that he has no respect for the United States or Mexico’s agreements with Washington. When he released a classified report from FINCEN, the super-secret U.S. intelligence gathering and asset seizure agency within the Treasury, at one of his daily news conferences, the United States was forced to suspend information sharing and other cooperation regarding drug trafficking with Mexico. AMLO has never apologized for his actions or even acknowledged that they were in violation of various treaties.

Castañeda worries that AMLO is going to take a far more nationalist path than any of his past three predecessors, while at the same time making good on campaign promises that could see Mexico’s hard-won fiscal stability thrown by the wayside. “AMLO has already made clear that there will be no privatization of energy and that even the limited joint-development

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projects with the private sector will be curtailed,” notes Castañeda. “Meanwhile, he has promised repeatedly, in person and in his television ads, to reduce the cost of energy for all Mexicans—gas, electric, and gasoline. The only way to do that is to increase subsidies and taxes.”

Far from privatization, Castañeda believes that under AMLO, Mexico will reassert its control over oil and gas production and may even merge the state oil and electricity monopolies to create a national “champion” in the energy sector. Investments called for by AMLO in areas like infrastructure, transportation, and agriculture all feature a leading role for the government and no explicit role for the private sector. Remember that the Mexican left takes many of its intellectual cues from the French, thus the idea of an assertive role for the state is seen as natural.

For many outsiders, it is hard to imagine that Mexico would turn back from the progress made over the past decade or more in areas such as economic stability and fiscal reform. In an interview with the *Financial Times*, Rogelio Ramírez de la O, whom many consider López Obrador’s first choice for finance minister should he win the July 2 election, stressed that fiscal and monetary discipline would be “very high priorities” for AMLO once in power. Ramírez did not respond to an interview request from *TIE*.

But if AMLO is true to his words and follows many of the prescriptions he has articulated over the past year or more, it seems unlikely that Mexico will remain the paragon of stability for which it has gained a reputation since the 1994 devaluation and financial crisis. If AMLO follows through with only half of the promises he has made along the road to the Mexican presidency, his nation’s hard-won achievements in areas such as inflation and political stability could become memories.

“In the first year or two, Mexicans and members of the left wing around the region will warm to AMLO and his powerful political skills,” warns Castañeda. “But by year two, it will be clear that there is not nearly enough revenue to support the agenda. Then we will have serious problems.” ◆