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NSC re Mexico
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We believe that in his Washington visit President de la Madrid will want to emphasize positive developments in Mexico and keep critical underlying realities off the table and invisible.

Chief among these realities are these:

-- Mexico's economic problems did not begin with the recent collapse of oil prices. The Mexican government began stimulating the economy two years ago in anticipation of mid-term elections. It would have been in financial trouble even had oil prices not declined.

-- The new \$12 billion rescue package the Mexicans are putting together, of which the IMF agreement is the centerpiece, is a short-term palliative, not a long-term cure. Mexico City will be back seeking additional financial help in 1988, if not sooner.

-- The Mexicans have not been ready to make the structural changes needed to put their economy on a sound footing. We believe de la Madrid understands what is needed but with a few exceptions--negotiating entry into GATT, closing down a bankrupt steel parastatal, and talk of additional airline divestitures--has yet to bite the political bullet. Moreover, we believe that these moves are largely intended to satisfy Washington and international creditors and that the pace of reform will grind to a halt late next year when a new presidential campaign season opens.

-- Poor economic conditions in Mexico contribute heavily to the continuing and growing surge of illegal aliens across our southern border. One half of the workforce is either unemployed or underemployed.

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-- The Mexicans have greatly overstated their oil reserves, are using them inefficiently, and not investing enough in exploration. Yet oil is the backbone of the economy. In recent years it has generated over 70 percent of export earnings and 45 percent of national revenues.

-- Little progress has been made on the narcotics front, despite de la Madrid's personal commitment.

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-- The Mexicans stopped selling oil to Nicaragua last year, but they continue to offer strong diplomatic support to the Sandinistas. Their Foreign Minister is in the lead in pushing for a Contadora agreement which would facilitate consolidation of the Sandinista regime.

The Mexicans are reluctant to deal with these underlying realities because many of the problems associated with them are deeply rooted or would require more political capital than the present administration is able or ready to use.

-- If the de la Madrid administration continues to look for temporary "fixes" rather than long-term solutions, it will be increasingly difficult to bail them out.

-- We believe that de la Madrid has the political clout to do more, but lacks the political will.

At present, he is under little external pressure to reform [REDACTED]

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For this reason, the Mexicans want to highlight positive aspects of bilateral relations in Washington and to avoid the more contentious underlying issues. There are some areas where we believe the Mexicans could do more to ease their next crisis and develop greater credibility to meet it.

-- They can adopt more evenhanded policies in Central America and, in particular, support efforts to promote democracy in Nicaragua. This would require that de la Madrid personally provide stronger leadership.

-- The Mexicans can take steps to open their economy to greater foreign investment, not just by altering regulations but by changing their attitudes and eliminating red tape.

-- They can do more on illegal immigration.

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-- They can develop ways to bring foreign investment and talent into their oil sector. They can take steps to diversify their export base to protect it from shocks associated with a volatile oil market. Brazil, although not an oil exporter, has benefited by diversifying its exports. ~~has shown that this can be done.~~

-- They can show a will to reduce the Mexican government's role in the economy by selling off additional state companies. A bolder move, such as returning banks nationalized in 1982 to the private sector, would require even greater political courage but would clearly signal a policy shift of the kind necessary to get the attention of its creditors.

-- With stronger leadership from de la Madrid, the Mexicans can make greater headway on the narcotics problem. We believe de la Madrid is sincere in wanting to stem the flow of drugs.

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Finally, one of the underlying realities of the Mexican situation is that many, if not most, of their difficulties are interrelated.

-- If Mexico does not open its economy to greater foreign investment, fails to reduce trade barriers, or does not invest more ⁱⁿ of its oil industry, for example, its economy will suffer.

-- If the economy declines, in turn, more Mexicans will emigrate to the United States, whether legally or otherwise. In addition, a greater number of Mexicans will enter the drug trade, and the potential for political instability will rise.

-- Unless these underlying realities are addressed by the Mexican government, our economic and security concerns to the south will be intensified and both we and the Mexicans will have an even greater set of problems to confront in the next round.

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