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Mexico Under José López Portillo: Problems and Prospects for US-Mexican Relations

National Intelligence Estimate
(Memorandum to Holders)

Secret

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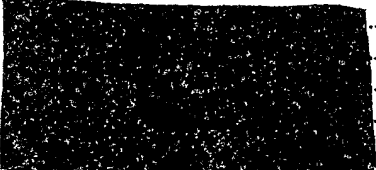
MEMORANDUM TO HOLDERS

NIE 81-1-76:

MEXICO UNDER JOSE LOPEZ PORTILLO:
PROBLEMS AND PROSPECTS FOR
US-MEXICAN RELATIONS

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INTRODUCTION AND SUMMARY

When NIE 81-1-76, *Mexico Under Jose Lopez Portillo: Problems and Prospects for US-Mexican Relations*, was issued last December, the Intelligence Community agreed to take another reading of the Mexican situation after the policies of Lopez Portillo, who assumed the presidency of Mexico on 1 December 1976, became more fully known. This paper aims to do that. The long-term outlook for Mexico will be examined in greater depth in an NIE to be written next year upon completion of basic research now under way within the Community.

Starting with his masterful inaugural address, Lopez Portillo, who presides over an authoritarian political structure, has established a didactic leadership style and projected a presidential bearing that have commanded the respect of the Mexican people. He also has proven to be a capable politician in his dealings with labor, business, and other interest groups. He has emphasized organization in restructuring the administrative machinery of the executive branch, and the same orderly approach apparently permeates his personal governing style. In all, the new President's approach has been rather low keyed, when compared to the flamboyant style of his predecessor.

Lopez Portillo has calmed the crisis of confidence brought on by the policies, rhetoric, and erratic action of the Echeverria administration and has made considerable progress toward stabilizing the economy after the tumultuous events of 1976. As was anticipated, he has placed financial stabilization and adherence to Mexico's stabilization agreement with the International Monetary Fund (IMF) well ahead of economic expansion and employment creation. Lopez Portillo emphasized in his 1 September state of the union address that he would not be tempted into premature reflation of the economy; a strong stand, since Mexico faces a fall in real per capita income for the second consecutive year and increasing unemployment and underemployment that could over time lead to social unrest.

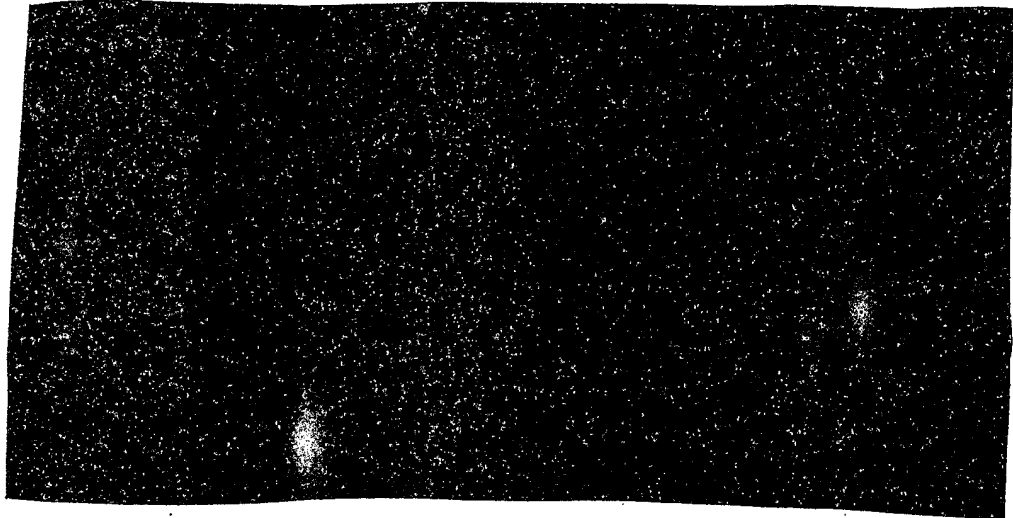
The longer term outlook for the Mexican economy is brightened because of vast oil reserves. Lopez Portillo has approved an ambitious investment program for Pemex, the state oil monopoly. The program, as stated, does not aim at maximizing output, however, and may prove actually to be relatively conservative. We believe that the program goals will be exceeded and that by 1980 production and export levels will be on the order of 2.2 million barrels per day and 1.2 million barrels per day, respectively. Such rates of exportation would allow

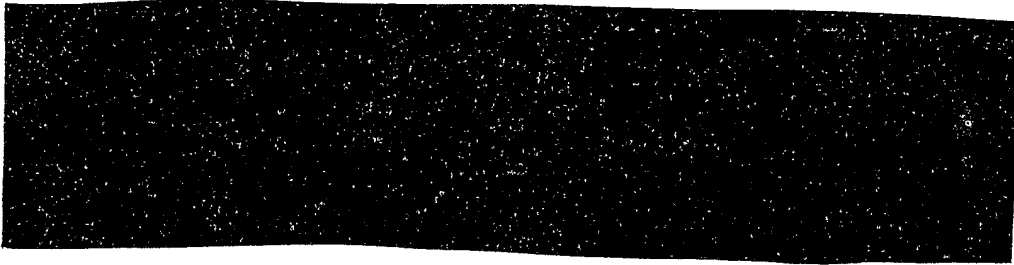
Mexico to achieve a substantial current account surplus. By the end of Lopez Portillo's term in 1982, Mexico could be well on the way to becoming one of the world's major oil exporters.

Although massive exploitation of Mexico's oil reserves cannot resolve the country's serious social problems, it can provide revenues to support the government's proposed attack on these problems. The challenge facing the government in implementing social and economic change should not be underestimated. We believe Lopez Portillo can prevent Mexico's social problems from becoming unmanageable during his term of office. His government should be able to maintain its authority through the traditional methods of coercion and cooptation.

Lopez Portillo is placing great emphasis on relations with the United States and consequently is not renewing the Third World rhetoric of Echeverria. A bilateral consultative mechanism to bring relations between the United States and Mexico into focus at the higher levels of government was established in February. The mechanism provides a medium for dialogue among policymakers and can smooth the conduct of relations between both countries. It allows for a dialogue to be developed over such issues as Mexico's investment laws before they reach the confrontational level. Lopez Portillo, however, has expressed disappointment with the mechanism because of what he sees as the incapacity of the mechanism to link bilateral issues and to facilitate immediate concessions.

Although foreign investors are optimistic over the potential for investment in Mexico, they are concerned that the government has not yet taken any action encouraging them and has, in fact, adopted some additional protective measures which may discourage renewed investment in Mexico. They are especially concerned over a new law regulating the automobile industry—which may portend similar laws for other industries.





DISCUSSION

I. MEXICO UNDER LOPEZ PORTILLO

A. Domestic Political and Social Policies

1. Jose Lopez Portillo began his six-year presidential term on 1 December 1977 at a time when the management of the Mexican economy presented more serious short-term problems than had been faced by any other incoming president in recent years. After the furor and confusion that accompanied the final days of the Echeverria administration and the near euphoria that greeted his inauguration, Lopez Portillo has proceeded to solidify his power, improve government efficiency, and undertake the protracted and difficult task of rebuilding Mexico's economy.

2. The President has followed the characteristic Mexican pattern of striving to consolidate his political control by appointing a Cabinet of personal associates and by establishing independence from his predecessor. We believe Lopez Portillo is completely in command of Mexico's governmental and political machinery, and any belief that former President Echeverria remains as a power behind the throne is a misperception.

3. In light of Mexico's ever-present yet potentially serious pressures, Lopez Portillo has worked to maintain firm internal security. He quelled disturbances at several universities—including Oaxaca and the huge national university, UNAM—by the judicious application of persuasion and force. The strike at UNAM was the most serious direct challenge his leadership has yet faced, and his ability to resolve it while avoiding a backlash from the left was impressive. The land dispute in Sonora, which arose when private farmers contested Echeverria's expropriation last year of 100,000 hectares of their farmland, has been settled along lines that should maintain Lopez Portillo's revolutionary credentials without further encouraging land invasions. The most active terrorist groups—the 23rd of September Communist League and the People's Revolutionary Armed Forces—still have the potential for spectacular actions, but their total numbers are small and the government is maintaining constant pressure.

4. The spectacular wave of terrorist bombings in September does not indicate that the government is

losing control. Although the bombings do demonstrate an impressive capability to coordinate and carry out a large operation, this is not a new development and does not represent a serious threat to the government's power.

5. The Lopez Portillo administration is giving strong support to a serious and far-reaching family planning program. Only recently have Mexican governments recognized the severity of the problem created by having one of the highest population growth rates in the world. The Lopez Portillo plan optimistically aims at reducing the population growth rate from 3.4 percent to 2.5 percent annually by 1982. In contrast to previous government efforts the \$250 million program is to emphasize limiting family size through contraception rather than improving maternal and child health. The program will be difficult to implement. Even if it succeeds in reducing the birth rate, the past baby boom guarantees that the labor force will grow at an average 3.4 percent through 1985.

B. Economic Policies

6. Lopez Portillo has calmed the crisis of confidence brought on by the policies, rhetoric, and erratic action of the Echeverria administration and has made considerable progress toward stabilizing the economy after the tumultuous events of 1976. As was anticipated, he has placed financial stabilization and adherence to Mexico's stabilization agreement with the International Monetary Fund (IMF) well ahead of economic expansion and employment creation.

7. Upon assuming office, Lopez Portillo instituted a major reorganization of the executive branch to reapportion administrative responsibilities among the Cabinet secretariats along more rational and efficient lines. Specific policy duties, especially in economic affairs, were consolidated in individual ministries to eliminate duplication and bureaucratic competition. A

Secretariat of Planning and Budget (modeled after the Office of Management and Budget in the United States) was created, and the roughly 800 government enterprises were placed under the supervision of appropriate Cabinet heads to make them more accountable. The large scale of the reorganization necessarily means that it will take time to iron out. Our preliminary assessment is that it is improving administrative efficiency and control, but that efforts to reduce the number of federal jobs subject to appointment, which was also part of the reform, will not succeed.

8. To help chart his economic course, Lopez Portillo has created an economic Cabinet under his personal chairmanship, which raises the hope that his government's economic policy will be planned and executed in a more coherent fashion. The President listens to advice and suggestions from his economic Cabinet, but in the actual policymaking process, no Cabinet member probably has as much influence as Rafael Gonzalez Izquierdo or Jose Antonio Ugarte, the President's private economic advisers. Lopez Portillo has moved deliberately through the profuse and often conflicting advice he has been receiving, seeking to avoid the rash implementation of ill-conceived policies characteristic of the Echeverria administration. At times this has led to reports that the President has difficulty understanding complex economic issues and in making decisions.

9. The great weight being given by Mexican authorities to meeting the IMF stabilization agreement reflects the influence of Izquierdo, Ugarte, and others calling for severe anti-inflationary measures and the realization that failure to implement the agreement would drastically reduce Mexico's access to foreign commercial credit. Mexico, so far, has stayed within the limit on foreign public borrowing and has more than met the monetary goals prescribed under the standard IMF deflationary package for overheated economies. The budget deficit probably will exceed the IMF target (in part because of increased spending on oil development) but will be below the deficit projected in the 1977 budget—a major accomplishment, considering recent deficits have exceeded the projected budget deficit by 50 to 130 percent.

10. Lopez Portillo has been most successful in trimming average wage increases from the inflated levels under Echeverria to about 10 percent this year. This has been indispensable for the government's economic stabilization program

each

1-percent increase in nonagricultural wages above productivity gains adds almost one-third percentage point to the inflation rate.

11. In imposing wage restraint, Lopez Portillo has worked closely with labor czar Fidel Velasquez, whose cooperation has been crucial in maintaining labor discipline. Velasquez, the 77-year-old leader of the Confederation of Mexican Workers (CTM), has dominated labor politics for 40 years. With respect to long-term political influence, "Don Fidel" is often described as the most durable man in Mexican politics.

12. Austere wage and financial measures initiated by Lopez Portillo have substantially reduced inflation, but at the cost of prolonging last fall's severe economic downturn. Although the sharp drops in real GDP and industrial production that followed the floating of the peso apparently bottomed out in the first quarter, demand remains depressed. The matching of last year's 2-percent increase in real GDP, far below the rate necessary to absorb all the new entrants to the labor force, is probably the best that can be hoped for. If the government held its deficit to the IMF target, the CIA's econometric model of the Mexican economy indicates that the inflation rate for the year would have been shaved only 4 percentage points from the 28 percent we currently estimate, while the required reduction in government spending would have cut the real economic growth rate to zero or -.5 percent.

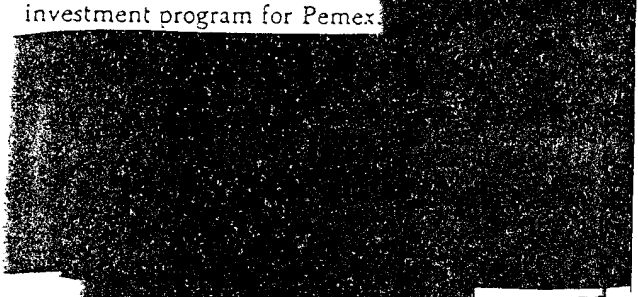
13. Economic recession coupled with the depreciation of the peso has resulted in a dramatic improvement in Mexico's current account deficit. The deficit should be reduced by about 50 percent to \$1.6 billion which, along with restrictions on government borrowing, will allow Mexico to stay within the \$3 billion IMF limit on net public sector (including Pemex) foreign borrowing while building up foreign exchange reserves.

14. Lopez Portillo is discouraged by the failure of domestic investment to pick up, as he was counting on this sector to provide the stimulus for economic growth. While Lopez Portillo has cleared away much of the bad feeling between the government and the private sector, business investment response is understandably slow. Companies are financially strapped by the large increase in the peso cost of servicing their dollar debt, and because "dollarization" of the economy has restricted credit even beyond what the government had planned. Presidential exhortation will play a role in reviving investment; in response to the President's pleas for increased private investment as a quid pro quo for labor's wage restraint, business

presented a 10-point job creation program just before the President's 1 September state of the union address. We believe that much of this program will be implemented. Fearful of new government intervention, the Monterrey industrialist group has warned that the political risks of not investing outweigh the economic risks of investing.

C. Oil Policy

15. Lopez Portillo and his chief advisers are convinced that increased petroleum and natural gas exports are necessary and have approved an ambitious investment program for Pemex.



16. Mexico could be producing 2.2 million barrels per day in 1980 and more than 3.5 million barrels per day in 1982. This would allow oil exports of 1.2 million barrels in 1980 and 2.2 million barrels per day in 1982. Pemex's \$15.1 billion development plan for 1977-82, although calling for lower production levels, is extremely ambitious but attainable. Pemex seeks to raise crude oil and gas production by 1982 to 2.24 million barrels per day and 3.63 billion cubic feet per day.

Pemex's own estimate for production in 1982 is very conservative; in February Mexico exceeded its daily production target for 1977. If current drilling success rates and average well production flows continue, the 477 development wells to be drilled onshore in the Reforma area alone will yield more than 2 million barrels per day.

17. In addition to the development plan, Lopez Portillo has approved the construction of 1,200-kilometer, 48-inch pipeline to move natural gas from the Reforma area to the US border. The line, which will take two to three years to complete once construction begins, will have an eventual capacity of 2.7 billion cubic feet per day. When the line initially comes into operation, possibly as early as 1980, Mexico will ship 1 billion cubic feet of gas per day to the United States; by 1982 this would rise to 2 billion cubic feet per day. Six US companies have already signed up for this gas, with only the price yet to be determined. The Mexicans want to price the gas at the equivalent

of Number 2 fuel oil landed in New York—much higher than the price acceptable to the US Government. The Mexicans see their bargaining position improved as negotiations are stretched out.

18. Pemex has the technological know-how and trained personnel to handle almost all phases of oil industry operations. Mexico is beginning to patent its inventions, especially in the refining area, and is supplying technical assistance to other countries. US firms continue to provide much of the equipment and technology employed by Pemex, but Pemex personnel perform all tasks in a competent manner. There is an element in Pemex and other sectors of Mexico which opposes rapid oil and gas development. However, this is more a political irritant than a political obstacle.



19. 20. The major potential constraint on Mexico's ability to carry out the Pemex development program and construct the gas pipeline is financial, if Pemex borrowing continues to fall under the IMF agreement. Pemex estimates that it will need to obtain half of the funds for its investment expenditures from foreign sources. Mexico, for the first time, is willing to commit gas exports to foreign companies in exchange for development financing and reportedly may be considering paying Japanese pipeline suppliers in crude oil exports after 1980. A potential constraint on Mexico's ability to construct the gas pipeline is the need for US Government approval of the Memorandum of Intentions signed in August with six US gas companies.



D. Foreign Policies

22. Lopez Portillo is placing primary foreign policy emphasis on relations with the United States and consequently is not striving for the leadership role in international affairs sought by former President Echeverria. This appears to be contributing to a reduction in confrontational tactics by Mexican delegates at international forums, but does not necessarily signal a reversal of Mexico's stand on key issues.

In truth, Mexico's basic national interests have not changed much under Lopez Portillo.

23. A bilateral consultative mechanism to bring relations between the United States and Mexico into focus at the higher levels of government and to provide a channel for the coordination of the operations of the various US and Mexican agencies involved was agreed to in principle by the presidents of the two countries in February 1977. A May meeting between Secretaries Vance and Roel established three working groups on political, economic, and social issues. By the end of August the economic and social working groups had held a full round of meetings.

24. The meetings have surfaced mutual problems and have attempted to design steps for pursuing solutions. The discussions deal principally with bilateral topics (for example, trade, tourism, and export of Mexican oil and gas to the United States), but multilateral topics (for example, the MTN) are also discussed. Moreover, they range from very specific measures, such as ways to liberalize visa requirements, to major policy questions, such as the problem of undocumented Mexican workers. Even without the consultative mechanism, existing agencies on both sides would probably have discussed the various issues from time to time. The mechanism provides, however, a medium for dialogue among senior policymakers, as distinguished from operational technicians, and can smooth the conduct of relationships that are increasingly important to both countries.

II. OUTLOOK FOR MEXICO UNDER LOPEZ PORTILLO

A. Political Prospects

25. The political reform program announced by Lopez Portillo in his 1 September 1977 state of the union address is not likely to diminish the power of the Institutional Revolutionary Party (PRI). The key

elements of the program are liberalized registration of political parties, greater representation for the opposition in Congress, and guarantees for minority party participation in local elections. Lopez Portillo's prime motive appears to be to channel political opposition into the present system in order to decrease the incentives for political violence.

26. The program has apparently run into stiff opposition from conservative elements within the administration and the PRI, however. These elements fear that even this limited program could eventually undermine the PRI's 50-year domination of Mexican politics. Although their fears are probably groundless in this instance, a more thorough program—such as has been occasionally demanded by elements of the Mexican middle class—could reduce the President's ability to stifle or deflect pressure through the traditional methods of coercion and cooptation and might usher in a period of political unrest.

27.

B. Social Prospects

28. Many of the problems facing Lopez Portillo are the enormous and intractable issues that faced his predecessor—skyrocketing population growth, a staggering unemployment rate, and an ever-widening gap between rich and poor. These problems are formidable, and the most deep rooted of them cannot be solved within the term of one administration. Not only will the government have a difficult time in obtaining the goals of its family planning program, but it would still take until the middle of the next century for Mexico's population to level off at about 110 million if the replacement rate of fertility were achieved by 1985. However, Mexico's potential for growth and its natural resource endowment should, with prudent

policies and a favorable international economic climate, keep these problems within manageable limits.

C. Economic Prospects

29. Lopez Portillo realized that rapid development of Mexico's petroleum reserves provides an opportunity for the country to tackle its economic and social problems and to implement a new development model that would provide growth with improved income distribution. Earnings from oil exports can make a major contribution toward correcting Mexico's international financial problem and helping it back on the path of rapid economic growth within a year or two. Given [redacted] projections for oil exports, it is possible to estimate Mexico's current account balance for 1978-80 under alternative scenarios for real economic growth. Oil exports under the Pemex plan would allow a substantial narrowing in the current account deficit in 1979 and 1980 if economic growth ranges between 6 percent and 10 percent annually, and a shift into surplus if growth is held to 4 percent. [redacted]

30. The outlook for Mexico's financial position is even brighter than these projections indicate, since the estimated export levels do not reflect gas sales to the United States, which could start two to three years after construction on the gas pipeline is initiated. A sharper increase than the conservatively projected 6-percent increase in oil prices used above would, of course, also speed improvement in the current account balance.

31. The administration currently is attempting to devise a new development strategy that would be export oriented and would provide for better income distribution. The challenge facing the government in implementing a strategy to improve income distribution should not be underestimated. Lopez Portillo does, however, appear to be effective at bringing disparate groups together and may ultimately be able to bring about a tax reform that would moderately improve income distribution. A radical program would hit the vested interests of almost all politically powerful groups in Mexico, and it is highly unlikely that Lopez Portillo would support such a politically risky effort. One advantage of the low-income base from which the distribution policy must proceed is that a relatively modest redistribution of earnings on the margin could substantially increase absolute

income levels of certain segments of the poor, thereby reducing social tensions.

32. Lopez Portillo is working to defuse the land tenure issue. In his state of the union address, the President strongly reemphasized that land redistribution no longer can fulfill agricultural workers' aspirations for a more equitable income distribution. Instead, he suggested rural labor legislation to improve agricultural wages. We believe that national land reform ideology will not dilute Lopez Portillo's basic determination to increase output, although small land redistributions may be continued in order to cement the President's revolutionary credentials and to buy off incipient peasant leaders and maintain peace in the countryside. Structural problems, however, will likely prevent substantial acceleration of agricultural output growth during the next five years.

III. IMPACT ON THE UNITED STATES

A. Outlook for US-Mexican Relations

33. The process of consultation set up by the bilateral mechanism should help illuminate the dynamics of policymaking on both sides of the border, especially the complex decisionmaking process of the United States. [redacted]

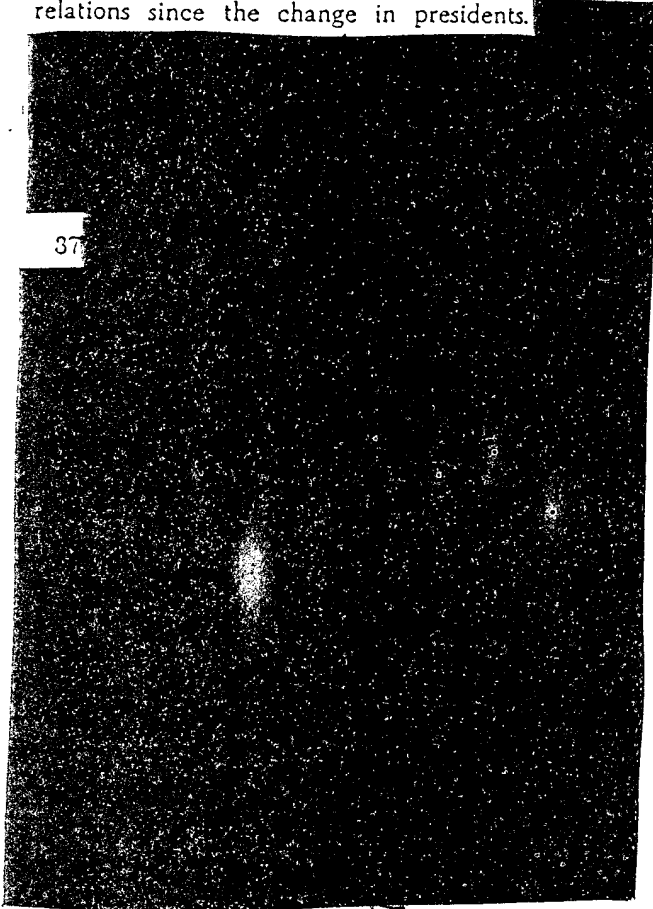
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B. Bilateral Issues

Illegal Immigration

36. In coming months, the Lopez Portillo government will continue to be highly concerned over the problem of undocumented aliens, and this issue—depending on US congressional action—may bring an end to the honeymoon that has existed in bilateral relations since the change in presidents.

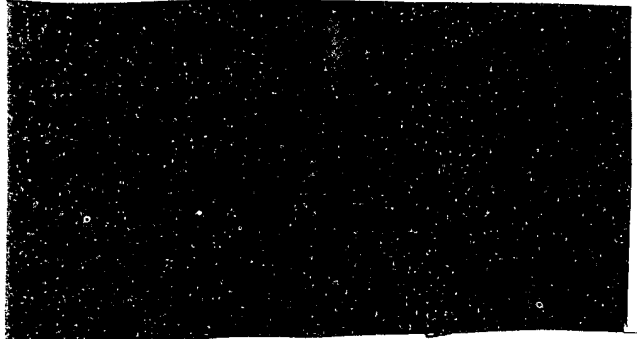
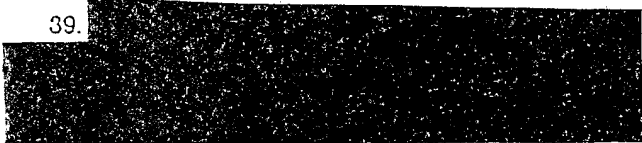


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Narcotics

38. The Lopez Portillo administration has been cooperating in the herbicide eradication program, and will probably continue to do so. We have indications that the program has reduced the amount of heroin produced in Mexico. Eradication of opium poppies does not bring progressive successes; however, failure to spray during one cycle of the growing season would wipe out previous gains. It is not a long-range solution.

39.



Foreign Investment

40. Mexicanization, although administered in a nondiscriminatory manner, continues to affect US private investment adversely. Indeed, a new law regulating the automobile industry affirms the nationalistic thrust of Mexican policy. The government has stated that it will not change its foreign investment laws; we believe, however, that Lopez Portillo recognizes the need for selected foreign investment and will reduce the red tape associated with the laws. He has stressed that, while Mexico welcomes foreign investment and indeed needs it, such investment must be selective and contribute directly to Mexico's development by creating jobs and earning foreign exchange.

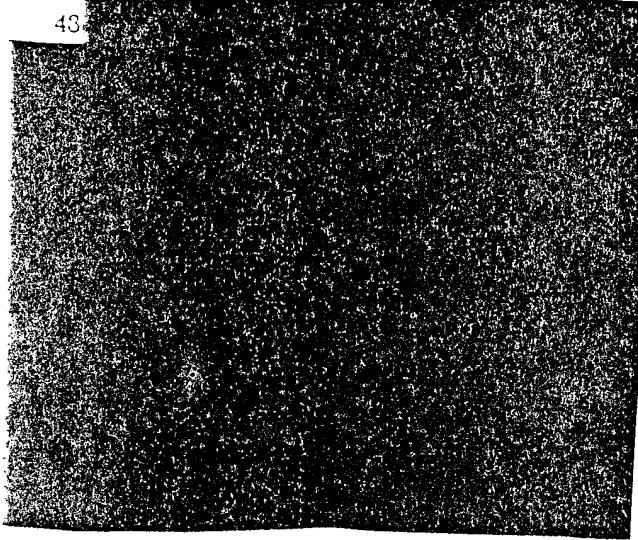
41. Officials of multinational corporations are encouraged by the government's attitude, but they are concerned, as they have seen no action—especially with regard to modification of the Patents and Trademark Law—that encourages them to renew investment in Mexico. Foreign investors are concerned that Mexican investment laws are being used to force foreign-owned companies to increase exports and investment levels in Mexico. Moreover, foreign investors will be carefully assessing the climate for financial stability, growth potentials, and continued freedom to remit profits. Though there are reports of proposed new and significant US industrial investments, it seems likely that foreign direct investors will remain cautious for the next year or so.

Oil

42. Although, as stated above, Lopez Portillo appears to desire a rapid and orderly expansion of Mexican oil production, such a result is by no means assured. Technical and equipment limitations could create obstacles to the government's carrying out its development program expeditiously. Provided the fact and appearance of Mexican sovereignty were protected, US companies might find acceptability for

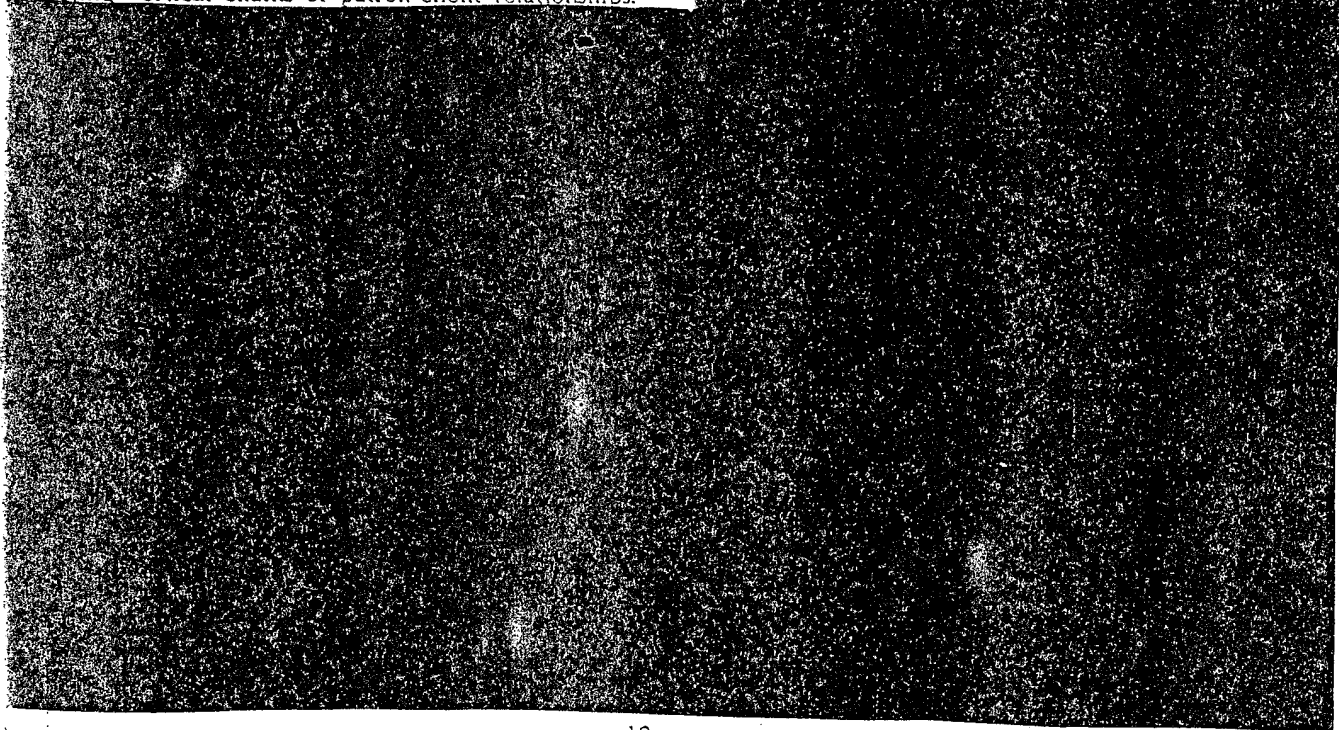
imaginative proposals involving provision of equipment and technical assistance—particularly for offshore development—and possibly construction of such infrastructure facilities as coastal storage and loading installations.

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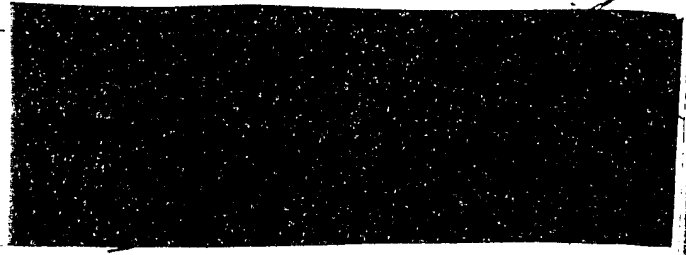
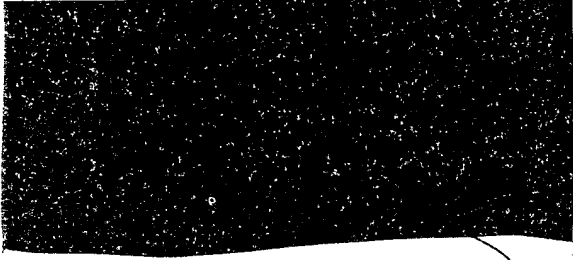


MEXICO: IMPORTANT ADVISERS TO
LOPEZ PORTILLO

The President makes all important decisions, and his support is absolutely necessary for the success of any program or policy. The keystone of the Mexican system is personalism, as it functions through interconnecting vertical chains of patron-client relationships.



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