[redacted] 25X1

Talking Points for the DCI
8 August 1986

Today, some of our more immediate concerns about Mexico's economy have eased. It now appears that new lending, and possibly debt payment concessions, will buy time for President de la Madrid, allowing him to cope with his country's immediate economic problems. Such assistance probably represents little more than a short-term palliative, however, for Mexico City remains unwilling to adopt the politically difficult structural adjustments that are needed to cure Mexico's economic ills.

The IMF Agreement

Mexico is seeking to put together a $12 billion rescue package to extend from now until the end of 1987. The centerpiece of this package is an IMF agreement signed on 22 July. The agreement will provide $1.5 billion in Fund financing over 18 months beginning in September. In addition, the program contains unprecedented contingency measures to allow for increased external financing if oil prices fall or the economy does not rebound sufficiently.

--The IMF agreement also features relatively easy targets for this year. For example, Mexico's deficit as a share of GDP is targeted at 16.9 percent this year, even though negotiations were deadlocked for months while the Fund pushed for a 5 to 6 percent level and Mexico argued for 13 percent.

[redacted] 25X1

--On the whole, Mexican policymakers are buoyed by the IMF agreement and, for the time being, seem convinced that they got a good deal. [redacted] 25X1

The Banks are Next

As expected, the IMF agreement has set the stage for negotiations with commercial banks, which could begin as soon as next week.

--So far, Mexico has told bankers that it will need $6 billion--$3.5 billion this year and $2.5 billion next year--as part of the overall $12 billion, 18-month new money package.

[redacted] 25X1

[redacted] 25X1

[redacted] 25X1

--The bank negotiations are likely to be difficult and could go on for several months or more. The reluctance of European and smaller regional banks to increase their exposure to Mexico at this time may prolong negotiations, but eventually most of them will fall in line. Those opting out probably will not carry enough weight to jeopardize the loan package.

The Longer Term is Troubling

Despite these positive developments, Mexico is clearly not out of the woods yet. GDP is now projected to fall 4 to 5 percent this year and inflation is expected to reach 100 percent. Next year, the inflation level could reach 120 percent.

More importantly, many of the policies that are at the root of Mexico's economic problems have not changed.

--We have seen progress on some fronts, most notably the commitment to join GATT, but movement in other areas, for example privatization and easing of foreign investment laws, has been piecemeal.

De la Madrid is unlikely to push hard for politically difficult structural adjustments since he feels relatively little external pressure. In addition:

--Powerful vested interests in Mexico, such as organized labor, strongly oppose such moves.

--De la Madrid [redacted] has adopted a short-term outlook. 25X6

[redacted] 25X6

Because de la Madrid has failed to make the fundamental economic changes needed now, his successor will inherit an economy in trouble and a public clamoring loudly for improvements in living standards.

Today some 800,000 jobs must be created annually to keep pace with the growing labor force. With some 50 percent of the population under 17 years of age, the pressure to increase jobs will be even more intense.

Political Implications

Mexico's economic difficulties, which are likely to grow if Mexico City does not alter its course, increasingly will translate into political ones, in our judgment. In particular, we believe election-related and labor unrest will increase.

[redacted] 25X1

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--Opposition protests, so far largely peaceful, could turn violent in September when newly-elected officials take over offices currently held by the PAN.

--Leftist parties also have been hurt by the government's election tactics. In response, they are stepping up efforts to work together and unify.

At the same time, organized labor, which has long been a bulwark of the regime, is becoming a source of greater uncertainty.

--After four years of declining real wages, labor will demand higher salaries. De la Madrid will find it hard to resist, even though he knows it will fuel inflation.

--Powerful independent unions, including the economically-vital Oil Worker's Union, increasingly have been willing to confront the government over political as well as bread-and-butter issues.

--Mexico's octogenarian labor leader, Fidel Velazquez, will not remain on the scene for many more years. His departure almost certainly will weaken labor discipline and could herald greater labor unrest.

As the government and ruling party decline in popularity over the next several years, Mexico City probably will become increasingly repressive.

[redacted] 25X6

--The government can control the Church by invoking constitutional provisions that prohibit priests from engaging in politics.

Although top military leaders have been grumbling about the government's policies, the armed forces show no sign of changing their traditional role as a force for stability.

[redacted] 25X6

Mexico's longer-term prospects will depend in large part on who is named to succeed de la Madrid. A decision will be announced in late 1987 after a complicated process of consultations in which de la Madrid will have the greatest influence.

--Key contenders now include Energy Minister del Mazo, Budget Minister Salinas, and Interior Minister Bartlett. None is a radical, but Mexican presidents have traditionally not defined their policies until after assuming office.

[redacted] 25X1

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--All of the probable successors are highly nationalistic. Each is likely, as de la Madrid has done, to regard foreign policy as a leftist preserve.

De la Madrid's successor will inherit an economy in growing trouble, a trend that will increasingly affect the United States.

--In the years ahead, the Mexicans almost certainly will look repeatedly to the United States to arrange financial bailouts, [redacted] 25X6 25X6

--Mexico City's strained resources will limit its ability to combat narcotics trafficking and will stimulate emigration pressures.

--At the same time, the Mexicans will oppose any linkage of financial matters to foreign policy, narcotics, or other questions.

In the final analysis, the Mexicans have no real alternative to working with the United States.

--Although Soviet Foreign Minister Shevardnadze will visit Mexico in September and General Secretary Gorbachev next year, Moscow's ties with Mexico City will remain largely symbolic.

Prepared by ALA/MCD/MX

National Security Council Meeting
Monday, 11 August 1986

Mexico

TAB A - Agenda

TAB B - Talking Points

TAB C - Background Reading

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TAB
A

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NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

CONFIDENTIAL

August 4, 1986

MEMORANDUM FOR MR. DONALD GREGG
Assistant to the Vice President for National Security Affairs

MR. NICHOLAS PLATT
Executive Secretary
Department of State

MS. SHERRIE COOKSEY
Executive Secretary
Department of the Treasury

COLONEL JAMES F. LEMON
Executive Secretary
Department of Defense

MR. JOHN N. RICHARDSON
Senior Special Assistant to the Assistant to the Attorney General and Chief of Staff
Department of Justice

MR. L. WAYNE ARNEY
Associate Director for National Security and International Affairs
Office of Management and Budget

[redacted] 25X1
Executive Secretary
Central Intelligence Agency

AMB HUGH MONTGOMERY
Deputy U.S. Representative for United Nations Political Affairs

REAR ADMIRAL JOHN BITOFF
Executive Assistant to the Chairman
Joint Chiefs of Staff

MR. LARRY TAYLOR
Chief of the Executive Secretariat
U. S. Information Agency

SUBJECT: National Security Council Meeting, August 11, 1986 [redacted] 25X1

There will be a National Security Council Meeting on Mexico on Monday, August 11, at 11:00 a.m. in the Cabinet Room. Attached for your information is the agenda for this meeting. [redacted] 25X1

Robert Pearson

Rodney B. McDaniel
Executive Secretary

Attachment
Agenda

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National Security Council Meeting
Monday, August 11, 1986
Cabinet Room
11:00-12:00 p.m.

Mexico

Agenda

I.	Introduction	John M. Poindexter (5 minutes)
II.	Intelligence Assessment	Director Casey (5 minutes)
III.	Policy Options	Secretary Shultz (5 minutes)
IV.	Financial Considerations	Secretary Baker (5 minutes)
V.	Discussion	All participants (35 minutes)
VI.	Summary	John M. Poindexter (5 minutes)

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TALKING POINTS FOR THE DCI

10 August 1986

[redacted] 25X1

--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 failed to make the structural changes needed to put their economy on a sound footing. De la Madrid apparently 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 explain why there has been a surge of illegal aliens across our southern border. One half of the workforce is either unemployed or underemployed.

--The Mexicans have greatly overstated their oil reserves and are investing little 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. [redacted] 25X6

--The Mexicans stopped selling oil to Nicaragua last year, [redacted] 25X6 25X6 25X6 They continue to offer strong diplomatic support to the Sandinistas. [redacted] 25X1 25X1

The Mexicans are reluctant to deal with these underlying realities because many of the problems associated with them are deeply rooted [redacted] 25X6

--Nonetheless, we are convinced that de la Madrid has the political clout to do more. At present, he is under little external pressure to reform [redacted] 25X1

For this reason, the Mexicans want to highlight positive aspects of bilateral relations in Washington and to avoid the more contentious underlying issues. It may be in our interest, however, to raise some of the tougher questions, particularly in cases where we believe the Mexicans could do more.

--We can ask the Mexicans to adopt more evenhanded policies in Central America and, in particular, to work to promote democracy. This may require that de la Madrid personally provide stronger leadership in this area.

--We can impress upon the Mexicans our desire to see them open their economy to greater foreign investment, not just by altering regulations but by changing their attitudes and eliminating red tape.

--We can ask them to do more on illegal immigration. [redacted] 25X6

--We can inform the Mexicans they need to invest more in their oil sector and that their present policy is penny wise but pound foolish. At the same time, they need to diversify their export base to protect it from shocks associated with a volatile oil market.

--Perhaps most important, we can urge the Mexicans to do more to reduce the Mexican Government's role in the economy and to restore to the private sector its rightful place. In part, this can be done by selling off additional parastatals. 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.

--Then too, with greater leadership from de la Madrid, the Mexicans should be able to make greater headway on the narcotics problem. We believe de la Madrid is sincere in wanting to stem the flow of drugs. [redacted] 25X6

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 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.

--Clearly, therefore, it would appear prudent to address some of the underlying realities during de la Madrid's visit and, more generally, to consider how they might affect US economic and security interests not just at present but in the years ahead.

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[redacted] 25X1

Talking Points for the DCI
8 August 1986

The financial bailout Mexico is getting from the IMF and the banks, which will total around $12 million through 1987, will ease Mexico City's immediate financial concerns, but will provide only a temporary respite.

--The terms of the IMF agreement are lenient and will not force the Mexicans to make the structural adjustments needed to put their economy on sound footing.

[redacted] 25X1

Mexico City has made a few moves to reform its economy in recent months. Most notably, it has closed a government-owned steel mill and negotiated entry into GATT. It is considering selling the two publicly-owned airlines.

--We believe that these measures are largely being taken to convince external creditors that Mexico is deserving of greater financial support.

--Such moves are politically difficult and de la Madrid is unlikely to push hard for additional reforms if, as is likely, they prove unpopular.

More generally, de la Madrid is trying to muddle through to the end of his term in 1988 without facing a new economic crisis or major social unrest.

--He knows that the popularity of his ruling party is waning.

[redacted] 25X6

In Washington, however, he will emphasize positive developments. De la Madrid will blame financial problems on the plunge in oil prices and assert that his government is acting responsibly.

--He will underscore his commitment to combatting drug cultivation and narcotics trafficking. We believe this commitment is genuine, and it is likely to be reflected in greater action in the weeks ahead, although progress in this area will be slow.

--De la Madrid will avoid Central America, fearing US pressure to change his pro-Sandinista diplomacy.

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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

18 July 1986

Mexico: Prospects for GATT Entry and Compliance [redacted] 25X1

Summary

Mexico City is moving toward GATT entry this summer, downplaying longstanding domestic objections to membership. We believe President de la Madrid has decided GATT membership is in Mexico's best interests and, unlike his predecessor in 1979, will push the necessary legislation through the political system, probably allowing little or no further discussion with groups still opposed to its passage. In our judgment, de la Madrid almost certainly is counting on GATT entry to serve as a sign to the international economic community of Mexico's willingness to initiate economic reforms. In return, Mexico is likely to begin pushing for greater access to US markets and new foreign loans.

Mexico City's changing attitude toward the treaty over the past year, in our judgment, stems largely from the realization that the country no longer can depend on petroleum revenues to boost economic growth. [redacted] 25X1
[redacted] most knowledgeable Mexicans agree the country's prospects for economic 25X1
recovery depend to a large extent on boosting nonpetroleum exports. However, we believe domestic expectations for immediate benefits and trade concessions--particularly in separate bilateral talks with the United States--are unrealistically high.

Even with domestic support, we expect Mexico will have some difficulty complying with some of the provisions of its GATT agreement, particularly elimination of its controversial official pricing system. In addition, although Mexico City seems positively inclined toward the treaty, the process could still be sidetracked if debt negotiations with the IMF or international bankers become stalemated. A rebuff from the international financial community would precipitate a nationalistic reaction within Mexico, making it more difficult for the President to sell GATT membership. [redacted] 25X1

This memorandum was prepared by [redacted] the Office of African and Latin 25X1
American Analysis. Information available as of 18 July was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Mexico Branch, Middle America-Caribbean Division [redacted] 25X1

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Laying the Groundwork

At the beginning of his term in office, President de la Madrid provided clear sign s of his seriousness about liberalizing Mexico's protectionist trade regime to make Mexican goods more competitive internationally. The President's official and publicly proclaimed program hinged on eliminating regulatory barriers, maintaining a competitive exchange rate, and moving toward entry into GATT to obtain more favorable terms from Mexico's major trading partners. His trade initiatives also projected a move from import licensing to tariffs, which he eventually planned to reduce in compliance with GATT regulations.

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During his nearly four years in office, the President has made progress, but it has been forged as much by outside pressure as by voluntary action. Pressure from the IMF caused de la Madrid to eliminate some of the more onerous regulations imposed by former President Lopez Portillo. Permit requirements have been discontinued for about 90 percent of exports, and most export tariffs have been reduced or eliminated. Further compelled by the IMF, the President announced in early 1985 that Mexico would liberalize its import regime by removing import license requirements for a number of products. This was followed up in July 1985 by the elimination of licenses for 90 percent of all import items.

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A need to compensate for falling oil export revenues over the past year added impetus to de la Madrid's nonpetroleum export drive, according to the US Embassy. In November 1985, he announced Mexico would begin serious negotiations with GATT member countries in preparation for entry this summer, in time to participate as a full member in a new round of negotiations to be launched in September in Uruguay. De la Madrid moved quickly to consolidate support for entry within the National Chamber of Deputies, despite complaints from Mexico's national labor union and private business organizations. The President also publicly affirmed that Mexico was negotiating a $500 million World Bank trade liberalization loan that would be contingent largely on GATT entry. These announcements were accompanied by moves to make Mexico's exchange rate more competitive, a verbal commitment to begin removing official reference prices on imports, and tariff reductions on a number of items. 25X1

Marketing GATT Domestically

Anticipating a negative reaction from domestic labor and some business organizations, President de la Madrid and Commerce Secretary Hernandez over the next several weeks probably will try to manipulate public opinion by spearheading a nationwide campaign to highlight the benefits of joining GATT and concessions obtained in negotiations. They are likely to point out that entry in August would allow Mexico to join other developing nations this fall in pressing for greater access to developed country markets. Mexico City already has joined a 'Group of 20' developing countries in formulating an agenda for the upcoming trade negotiations, providing further evidence of Mexico's intention to join. Secretary Hernandez also is likely to stress that Mexico City successfully argued for developing nation status and special protection for the country's agricultural and energy sectors. 25X1

We also expect Mexican officials to soften resistance to GATT entry by domestic industries by committing the government's help to ease the transition. Some evidence of such a commitment is already occuring. Mexico City has publicly announced it will spend almost $5 billion dollars as part of a concerted effort to promote exports of nonpetroleum

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products. According to Secretary Hernandez, the program will concentrate on loans to increase production, export competitiveness, and imports of raw materials and industrial equipment. The Commerce Secretary also has vowed to reduce or remove taxes and duties that make Mexican products less competitive abroad. Changes in foreign exchange rules also are slated to allow exporters to use 100 percent of the foreign currency earned from sales to pay for imports. [redacted] 25X1

We believe President de la Madrid almost certainly will meet privately with prominent business leaders concerned over GATT entry to allay fears their companies may be shut down by competition from cheaper foreign products. He is likely to stress that Mexico City will continue to apply taxes and surcharges on imports that directly compete with domestic goods. We expect the President also will promise to push for justification under GATT regulations for import quantity restrictions in areas where companies become threatened. [redacted] 25X1

Prospects for Passage

There appear to be no major obstacles to joining GATT this summer, according to a wide variety of US Embassy sources. [redacted] 25X1 Now that GATT members have signed the agreement, Mexico City will have until 15 August to declare its readiness to join. We believe [redacted] 25X1 [redacted] 25X1 that Mexico City probably will sign the agreement next month in order to become eligible to participate in the upcoming round of trade negotiations. [redacted] 25X1

Mexico's change in attitude toward GATT entry over the past year [redacted] 25X1 [redacted] 25X1 stems largely from the realization that the country no longer can depend on petroleum revenues to boost economic growth. In 1979, in the midst of an oil boom, former President Lopez Portillo could easily afford to declare Mexico's prospective GATT protocol unacceptable because it would impinge on the country's ambitious development plans. Now, however, de la Madrid has stated Mexico's prospects for development depend almost exclusively on boosting sales of nonpetroleum products. With domestic demand plummeting in the midst of a major recession, Mexican businessmen have told US Embassy officials that they have little alternative but to seek foreign markets for their goods. [redacted] 25X1

Even though many Mexican entrepreneurs have complained that the President has moved more rapidly than expected, local business leaders, in general, support entry into GATT. The strongest private sector support for GATT membership comes from the large manufacturers in Monterrey, Mexico's biggest industrial city. Many are operating well below capacity and are counting heavily on government export loans and the opening of new overseas markets. On the bilateral front, we believe that a number of companies are depending on GATT entry to help gain favorable trade concessions from Washington. Opposition to entry by small and medium size firms in the agriculturally-based Guadalajara area may have been at least partially neutralized by strong language in the GATT agreement protecting Mexico's agricultural sector, according to the US Embassy. [redacted] 25X1

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Complying With Tough Entry Terms

President de la Madrid has agreed to a much stricter interpretation of GATT principles than his predecessor, Lopez Portillo, had negotiated in 1979. [redacted] 25X1 Even though Mexico City initially pushed for broad exceptions to GATT rules for nine of Mexico's economic sectors, [redacted] Mexico eventually accepted the standard terms of accession, 25X1 with exceptions only for agriculture and energy. The only other concession Mexico gained, according to the draft protocol for Mexican accession to GATT, was specific note of the country's present status as a developing country. This allows Mexico to apply quantitive restrictions on imports if they threaten domestic industries, the country's foreign reserve position, or implementation of the government's National Development Plan or its sectoral and regional programs. [redacted] 25X1

In our judgment, Mexico City probably will attempt to comply with most of the basic terms required of GATT members. Mexico will find it relatively easy to stay within the 50 percent tariff ceiling imposed by the accession agreement--most of the country's tariffs already are at or below this level. The government already has gone far toward reducing the number of items requiring import permits. We believe, on the basis of US Embassy [redacted] reporting, Mexican Government officials probably will argue that the 25X1 remaining permits--controlling about one-third of the value of total imports--are needed to protect domestic industries from excessive competition. Mexico almost certainly will take advantage of the extended time period--until 1990--allotted to reduce taxes and surcharges on imported goods. [redacted] 25X1

Despite a general willingness to conform to GATT regulations, de la Madrid will have difficulty making progress in some areas. In our view, Mexico City is unlikely to keep its reluctant promise to eliminate its controversial official pricing system--a mainstay of the government's import restriction policy--over the next 18 months. The government still depends greatly on official prices to keep imports from undercutting domestic industries, and has indicated to local businessmen that it will continue to use pricing yardsticks, according to the US Embassy. By the same token, the six-month time limit agreed to for adherence to four nontariff barrier codes (licensing, customs valuation, antidumping, and standards) and to initiate negotiations for accession to the code for subsidies and countervailing duties, in our judgment,will be difficult for the government to meet. 25X1 Domestic business demands for subsidies and customs protection almost certainly will cause officials to continue practices in these areas that are contrary to GATT principles. [redacted] 25X1

The Downside Risks

Mexico City, even at this late stage, still could change its mind at the last moment and refuse the GATT entry offer presently being voted on by member countries in Geneva. Should negotiations with the IMF or international bankers be stalemated, Mexico probably would be tempted to use GATT entry as a negotiating pawn. De la Madrid almost certainly would argue that Mexico could not be expected to proceed further with import liberalization without inflows of new money to finance the resulting increases in foreign purchases. A final rebuff from the international financial community probably would precipitate a nationalistic reaction within Mexico, making it exceedingly difficult for the

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President to be seen as submitting the Mexicans to the dictates of the developed countries--particularly the United States--by joining GATT. In such a case, de la Madrid could choose to throw the issue open for public discussion--as Lopez Portillo did in 1979--encouraging groups within Mexico to publicly oppose GATT entry. 25X1

Implications for the United States

If de la Madrid does proceed with plans to join GATT, he is likely to present Mexico's membership to foreign creditors and government officials as a significant sign of his country's seriousness about economic reform. 25X1

Mexico City almost certainly will use GATT entry to push for greater access to US markets. Officials are likely to argue that US pressure to accede to GATT will impose a net burden on Mexico and that it, therefore, should be compensated for reversing its trade policies. Mexican negotiators probably will try to capitalize on US interest in Mexico's GATT entry by pushing for liberalized treatment of Mexican exports of winter vegetables and fruits, a relaxation of restrictions on meat and textile shipments, or improvement in the US GSP program, especially in the competitive need limitations. 25X1

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The Director of Central Intelligence

Washington, D.C. 20505

National Intelligence Council

NIC 03684-86
6 August 1986

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

FROM: Robert D. Vickers, Jr.
National Intelligence Officer for Latin America

SUBJECT: Scheduled NSC Meeting on Mexico

1. The purpose of the scheduled NSC meeting on Mexico on 11 August is to discuss longer-term policy options towards Mexico and to better coordinate such options within the Administration. The recent IMF agreement with Mexico and the decision by the US Treasury and Federal Reserve to support additional lending will only buy time for Mexico's troubled political and economic system. There is concern within the NSC and State Department that this support does not force Mexico to take any hard actions to revamp its economy. Without fundamental changes and reforms, Mexico is likely to go from economic crisis to economic crisis, each time requiring large US and international bailouts.

2. The last NSC meeting on Mexico was held in 1982 shortly after the initial massive US bailout of the Mexican economy. At that time, the NSC participants were optimistic that as a result of our assistance, we could expect greater efforts on the part of the Mexican government to reform its economic and political system, opening them up to greater competition. In particular, the Administration was hoping that Mexico would allow greater initiative to private enterprise and open up the country to more foreign investment. Unfortunately, this has not been the case, and four years later Mexico still has failed to make the basic reforms necessary to revamp the economy.

3. The IMF agreement allows Mexico to pursue a policy of economic stimulation and growth rather than a policy of austerity, and sets economic guidelines which the Mexicans are unlikely to meet. Without opening up their economic system to increased competition and foreign investment, the Mexicans are likely to stimulate growth through greater government spending, higher inflation and larger budget deficits. This may buy de la Madrid the political and economic support he needs to take his party into the 1988 Presidential elections, but it is unlikely to address the more fundamental problems within the system and will risk continued political and economic instability.

Fyi from Vickers—
Vickers won't be here
for NSC prebrief
on Friday

Robert D. Vickers, Jr.

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SUBJECT: Scheduled NSC Meeting On Mexico NIC 03684-86

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