



AMERICAN CHAMBER
MEXICO

Foreign Direct Investment in Mexico: Is your Investment Safe?

deserve your dream

-Octavio Paz-

Foreign Direct Investment in Mexico: Is Your Investment Safe?

Executive Summary

The Mexican government is engaged in a vital effort to disrupt and dismantle drug cartels. The military has been called in, local police are being reorganized, retrained and purged of corrupt elements, and changes have been made to streamline criminal trials. The result has been an unprecedented number of arrests, extraditions, prosecutions and large-scale seizures of drugs, weapons, cash and assets. These efforts have also led to increased violence as criminal gangs confront government forces and battle among each other for control of key territory.

These events have been widely publicized on both sides of the U.S.-Mexico border. The media coverage, however, often fails to provide sufficient context. **AMERICAN CHAMBER OF COMMERCE OF MEXICO (AMCHAM)** is aware that the perceptions of Mexico as a place to live, work and do business are very often at odds with the reality.

Although the number of armed confrontations has increased markedly since the government's enforcement efforts were implemented three years ago, the widely-reported death toll is confined to a relatively small region of the country. Moreover, the vast majority of the victims are either drug traffickers or the officials trying to stop them. While the risk of being a victim of random drug-related shooting is minimal, it must be acknowledged that crime does have an impact on business in Mexico. As reported by our members in the 2010 Security Survey, the areas most affected include employee security, executive protection and transportation of goods.

As **AMCHAM** members will readily attest, Mexico offers tremendous investment opportunities. Since joining NAFTA, Mexico has developed a stable market economy, now the eighth largest in the world, and enjoys a solid record of macro-economic success. The middle class is now the largest socio-economic group in the country. In addition, China's low wage advantage has all but disappeared while transportation costs have soared. As a result, Mexico with its myriad of free trade agreements, is perfectly positioned to serve as an export platform for manufacturers. In 2010 alone, a number of foreign companies have announced investment plans involving hundreds of millions of dollars to create or expand productive capacity in Mexico or to serve the burgeoning middle class.

Mexico is a strategic economic partner of the U.S. **AMERICAN CHAMBER/MEXICO** is committed to working with Mexico in its efforts to reduce crime, to create more and better economic opportunities for its citizens, to improve transparency and the rule of law, and to promote greater integration between our two nations.

Foreign Direct Investment in Mexico: Is Your Investment Safe?

I. Introduction.....	2
II. Pulling Out of the Global Recession.....	2
III. Drug Cartels and Their Impact on Doing Business in Mexico.....	3
IV. The Outlook for Foreign Direct Investment in Mexico.....	5
V. What Remains to Be Done.....	9
VI. Conclusion.....	11
Appendix.....	12

I. Introduction

AMERICAN CHAMBER/MEXICO believes that while the recent spate of insecurity has put a cloud over Mexico's business climate, Mexico remains an excellent choice for investors: the country has a strong and growing internal market, offers a competitive manufacturing environment with excellent geographic location and has solid macro-economic fundamentals.

On May 19th, 2010, in the company of Mexican President Felipe Calderón, U.S. President Barack Obama quoted renowned Mexican author and Nobel laureate Octavio Paz who wrote that “**you must deserve your dream.**” It is not enough to dream of a prosperous and democratic country unburdened by poverty, illiteracy, delinquency and corruption. Tough choices have to be made and strong measures must be taken to turn those dreams into reality. From the 2000 elections marking Mexico's full membership in the club of democratic nations to the courageous battle now being fought against organized crime, the Mexican people deserve their dream.

II. Pulling Out of the Global Recession

A. An Economy Bouncing Back

The global financial crisis hit Mexico especially hard. Over 85% of the country's exports are destined for the U.S. As credit dried up and consumer confidence eroded, the U.S. market for automobiles, home appliances and electronic goods collapsed. At the same time, Mexico saw its oil revenues decline significantly as global prices plunged. When the U.S. building boom went bust, many Mexican immigrants found themselves out of work and unable to send money home. Finally, the A-H1N1 (swine) flu pandemic erupted with Mexico at the epicenter. Business and tourist travel dropped sharply as a result creating a large hole in Mexico's tourism revenues representing 12.6% of the country's GDP.

In the end, the Mexican economy shrank by 6.5% in 2009. Since then, the economy has bounced back. **GDP is expected to grow by 3.9% in 2010** and unemployment, currently at 6.1%, is expected to decline to 5.9%.

Mexico's most recent economic difficulties were not of its own doing. Unlike the U.S. and Europe, Mexican financial institutions did not engage in reckless lending practices. To the contrary, **the Mexican banking system is very sound.** In fact, Mexico has been a model of economic stability since at least the early 1990's. And with an average per capita income of over \$7,800 USD, Mexico is considered a relatively wealthy country by World Bank standards.

Key Economic Indicators for Mexico

	1999	2009a
Population (millions)	99	111
Nominal GDP (US\$ billions) b	520	875
GDP, PPPc Basis (US\$ billions)	969	1,611
Per Capita GDP (US\$)	5,277	7,870
Per Capita GDP in \$PPPs	9,825	14,480
Total Merchandise Exports (US\$ billions)	136	230
Exports as % of GDP	28%	26%
Total Merchandise Imports (US\$ billions)	142	234
Imports as % of GDP	30%	29%
Public Dept/GDP	44%	39%

Source: Compiled by U.S. Congressional Research Service, based on data from Economist Intelligence United (EIU) database.

Notes:

a. Some figures for 2009 are estimates

b. Nominal GDP is calculated by EIU based on figures from World Bank and World Development Indicators.

c. PPP refers to purchasing power parity, which reflects the purchasing power of foreign currencies in U.S. dollars

Indeed, **Mexico has run a responsible macroeconomic policy** for the last several years. The country has more free trade agreements than any other country in the world. Moreover, **Mexico more than halved its import tariff** average rate (from 11% to 5%) to the rest of the world. Inflation was brought down to U.S. levels and its accumulated foreign reserves have helped Mexico weather this economic downturn. At the same time, the flexible exchange rate has helped stabilize the peso. All of this was accomplished while also transitioning to a representative democracy after 70 years of single-party rule. Not many countries could have accomplished such a feat.

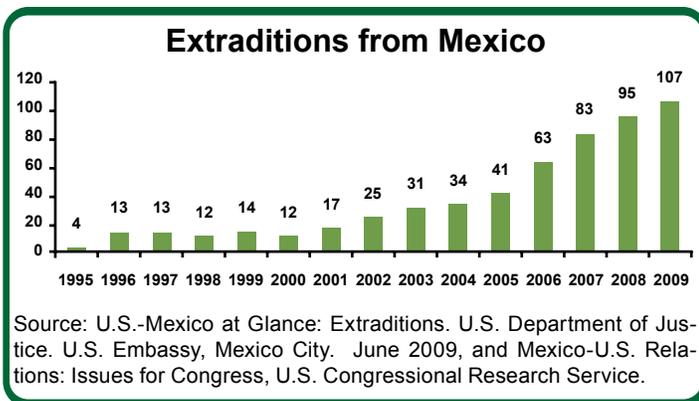
There are a number of reasons to be positive about the **prospects for economic growth and stability in Mexico.** First, Mexico enjoys enormous benefits owing to its proximity to the United States. Geography will become even more pronounced as manufacturers

move away from outsourcing and embrace near sourcing, while China continues to lose its once considerable cost advantage. Second, **NAFTA offers legal protection to U.S. investors** in Mexico that operates independently from the domestic legal system. Third, Mexico has a young, hardworking and well trained labor force; in fact, according to Engineering Trends, Mexico graduates more engineers per capita than Brazil, China and even the U.S. Fourth, Mexico and the U.S. enjoy strong cultural and business linkages.

Finally, the Mexican government has implemented a number of initiatives designed to enhance Mexico's competitive position. The National Infrastructure Program will upgrade the country's railroads, highways, energy sector and ports. Antitrust legislation will reduce the power of long-standing monopolies and Mexico will continue down the path of greater transparency and more effective legal regimes including the protection of intellectual property rights.

B. A Change in Law Enforcement Policy

Shortly after taking office, **president Calderón announced a policy shift toward drug trafficking** from one of tacit acquiescence to one of **disruption and elimination**. The government has deployed thousands of troops and federal agents to interdict drug shipments flowing north and cash and weapons coming south, and to arrest, prosecute, convict and extradite those involved in drug trafficking and money laundering.



The reaction from the drug cartels has perhaps been more aggressive than anyone anticipated. In addition, the drug cartels have been battling each other

for control of the most lucrative trade routes into the U.S. The increase in the death toll and the number of clashes between government forces and the cartels has dominated the headlines. Unfortunately, news reports rarely provide the depth and context necessary to put these activities in perspective as they impact daily activities, business operations, and particularly, as they relate to foreign investment in Mexico.

III. Drug Cartels and Their Impact on Doing Business in Mexico

The same geographic proximity that makes Mexico an attractive investment destination also makes the country highly desirable for drug trafficking. Sharing over 2,000 miles of border with the U.S., Mexico serves as an ideal transit route. Because Mexico has historically been a major supplier of cannabis and heroin, drug traffickers could tap into a well-developed infrastructure to import and push cocaine through the pipeline. It is estimated that approximately 70% of illegal drugs flowing into the U.S. cross at the Mexico-U.S. border.

President Calderón has taken measures to confront the cartels head on. He ordered over 6,000 federal troops into his home state of Michoacán in an effort to put an end to the drug violence. Since then the pressure has been steadily ratcheted up to the point that there are now approximately 45,000 military personnel along with elements from the federal and state police involved in these operations.

Sadly, these efforts have led to a number of casualties. Thousands of cartel members have been killed in clashes with government forces. As cartel leaders have been killed or incarcerated, rival groups have waged a fierce war to capture territory. Many of the most heavily publicized homicides are the result of gang-on-gang confrontations.

However, it is important to put these deaths in context to understand how they impact daily life in Mexico. Since early 2006, an estimated 23,000 people have died in connection with narcotics trafficking. **About 90% of those killed were cartel members.** Approximately 7% of the victims were soldiers, police or other government agents who lost their lives in

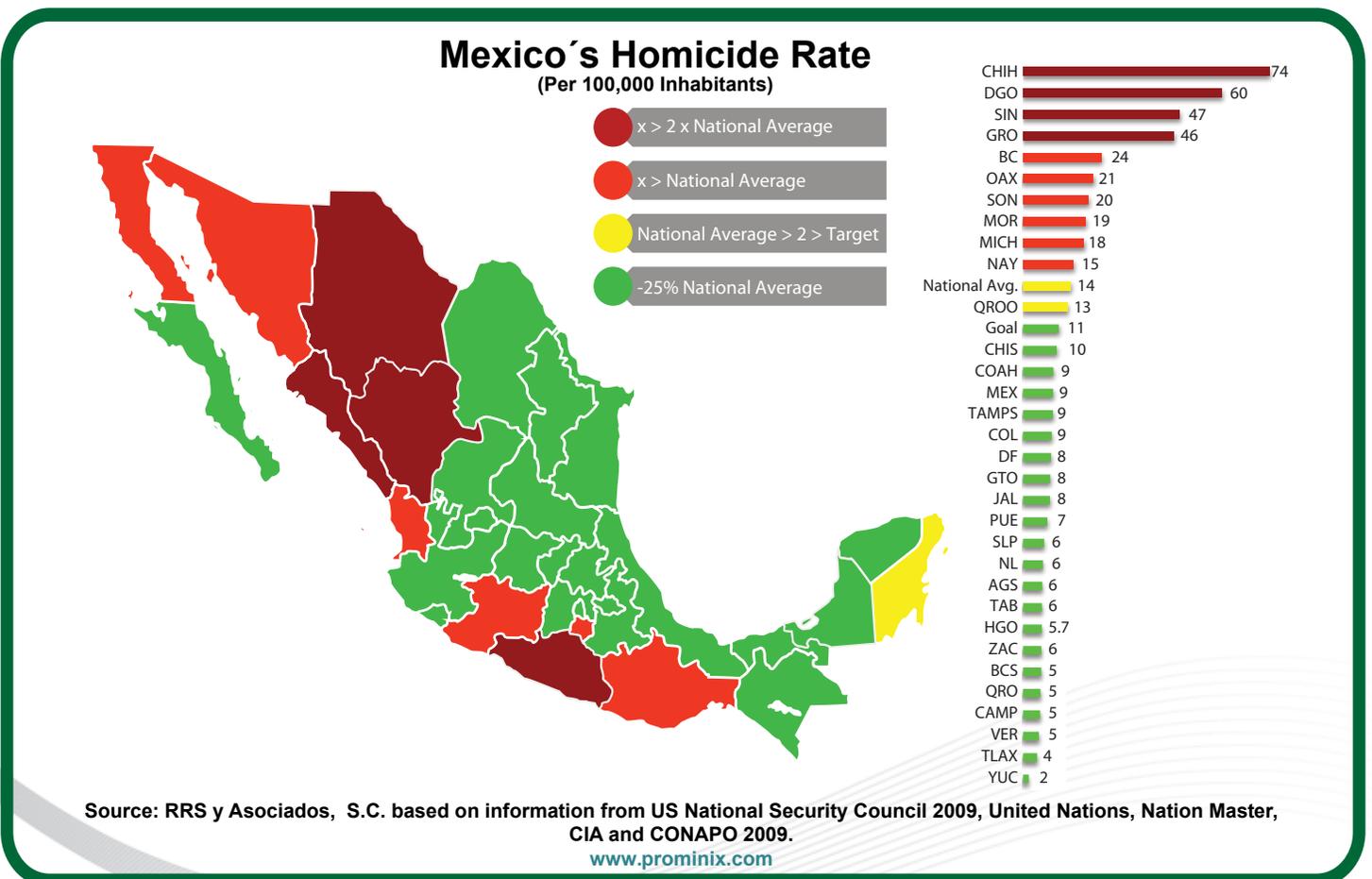
the line of duty. Roughly 3% of the deaths involve innocent bystanders. Although any civilian loss is unacceptable, statistically speaking, in a country with over 110 million inhabitants, the risk of becoming a victim of drug violence is extremely small.

In addition, the **confrontations are concentrated in relatively few regions within the country**. These areas tend to be along the drug trafficking corridors including the border cities of Nuevo Laredo, Reynosa, Ciudad Juárez and Tijuana. To be sure, residents of these communities have experienced significant disruptions in their day-to-day lives. Bars and restaurants have been especially hard hit. However, the vast majority of the country’s population is removed from the criminal activity. A fair analogy would be the inner city violence related to the U.S. crack cocaine trade in the early 90’s. For those residents living in parts of Los Angeles, Chicago and New York, the situation was disruptive and dangerous. However, it did not have a significant impact on U.S. life outside the inner city.

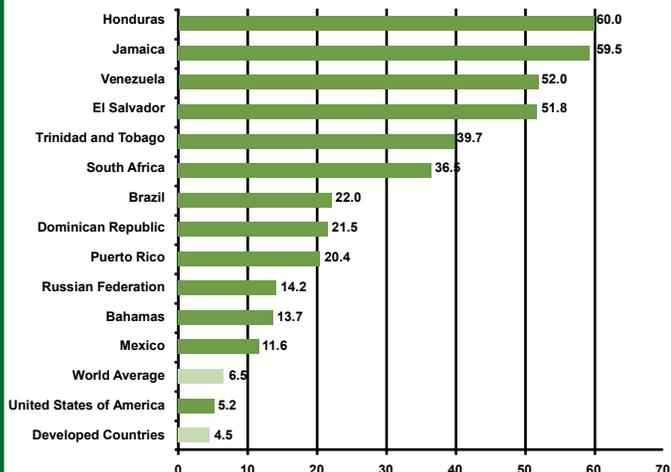
According to the United Nations, Mexico’s homicide rate of 11.6 per 100,000 residents, while unac-

ceptably high is still lower than that of many other countries such as: Brazil, Colombia, Dominican Republic, Ecuador, Jamaica, Russia, South Africa, Venezuela and all Central America, except Costa Rica. In fact, it is lower than the murder rate in Mexico itself in the early 1990’s. On a city-by-city basis, the homicide rate of 6 per 100,000 residents in the northern industrial city of Monterrey is much lower than that of U.S. cities such as Washington, D.C. at 31.4, Detroit at 33.8 and New Orleans at 90.

Although armed incidences involving drug cartels are isolated in terms of both geography and those involved, general crime rates and the level of insecurity in Mexico have risen in recent years. Even though drug trafficking continues to be their primary source of revenue, many of these organizations have branched out into other criminal activities such as extorting “protection money” from small and medium-size businesses, counterfeiting, credit card fraud, traffick- ing in illegal immigrants, property crime (including the theft of merchandise and cargo) and kidnappings for ransom. AMCHAM members report having to invest on average 3% of their operating costs on security to respond to these trends.



Intentional Homicide Rate (selected contries) per 100,000 population (2008)



Source: United Nations Office on Drugs and Crime Homicide Statics, Criminal Justice

IV. The Outlook for Foreign Direct Investment in Mexico

A. Investment in Mexico

Nothing speaks louder and more directly to the international business community’s confidence in Mexico than the spate of recent investment decisions by multinational companies. In the first few months of 2010 alone, millions of dollars in foreign direct investment commitments have been announced. It is projected that **FDI for 2010 will total \$19 to \$22 billion** which would be on par with 2006 levels.

Foreign Investment in Mexico (in Billions of USD)

	2006	2007	2008	2009	2010p	2011p
Direct	19.3	27.3	23.1	11.4	19-22	18-21
Portfolio	6.4	8.5	2.4	7.6	5-15	3-16

Source: Charting the Economy – 2nd Quarter 2010 – AMERICAN CHAMBER/MEXICO

The economic crisis has had an impact on crime rates in general. Mexico has a weak social safety net especially relating to unemployment protection. Increased layoffs, a lack of job opportunities and reduced remittances from abroad may be driving more people to join criminal organizations or simply to pursue criminal activities on their own.

However, it is important to understand that **Mexican civil society operates largely in the same way it did prior to the government’s push to dismantle organized crime.** Mexico is not in the midst of a civil war or on the verge of collapse. Mexicans go to work and school every day, factories and service providers continue to operate, financial institutions are functioning, property is bought and sold, regulators issue permits, and the list goes on.

As the various reform efforts aimed at improving the criminal justice system begin to produce results and as the Mexican and global economies continue to recover, job opportunities will return, and consequently, crime rates related to economic necessity should begin to edge back down. Moreover, there are a number of reasons for optimism concerning Mexico’s economic outlook.

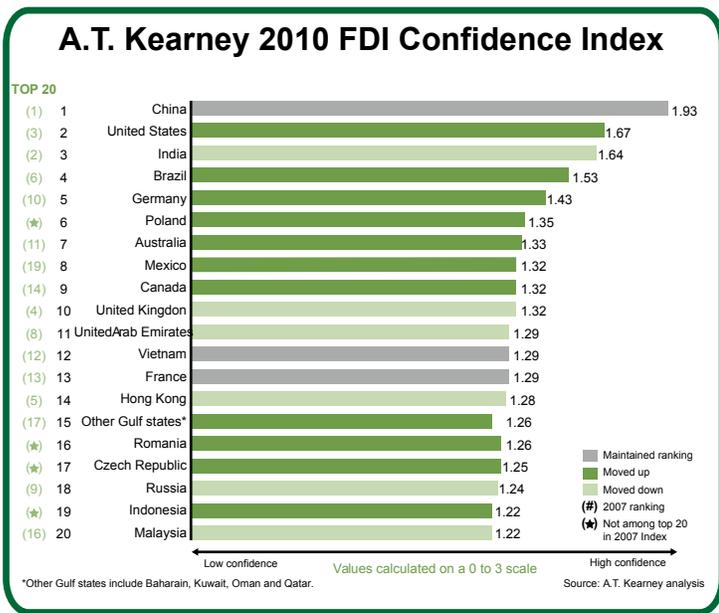
Walmart—the leading retail chain in Mexico—recently announced plans to invest \$1 billion to open 300 new stores throughout the country in 2010. Retailers such as Lowes and Best Buy have just begun operations in the country where The Home Depot has been very successful for the last several years. These and other investments reflect a core belief in the stability of Mexico and the growth and purchasing power of the Mexican middle class.

In the manufacturing sector, the list of projects is extensive including Nissan’s plans to invest \$600 million in a new assembly plant for the new Micra; the Chrysler/Fiat investment of \$550 million; Procter & Gamble’s decision to build a \$250 million razor blade plant in Guanajuato; and the new \$445 million Freightliner truck plant in Saltillo, to name just a few.

Ciudad Juárez is an excellent example of Mexico’s strengths. If there is a ground zero for the drug violence in Mexico, Ciudad Juárez is surely it. Yet every day thousands of engineers and managers drive across the border from El Paso to work at plants owned by such companies as Delphi, Johnson Controls and Em-

erson Electric. According to Randy E. Wilcox, president for the Americas for Otis Elevator: “Not only are we not going anywhere, but more and more of our key suppliers are in Mexico... It’s the hub of our supply chain for North America.”

Financial commitments on this scale simply would not be made if the global business community did not have the **utmost confidence in the stability of Mexican society, the ability of the Mexican government and its institutions to deal with security issues and the other challenges Mexico is now addressing.**



According to the *Mexico Competitiveness Report 2009* published by the World Economic Forum and Harvard University: “In the last decade or so, Mexico has made impressive progress toward achieving macroeconomic stability and liberalizing and opening its economy, leaving behind a recent past of recurring financial crises linked to changes in the administrations, oil price volatility and fiscal excesses, among other factors, and establishing a solid foundation for sustainable long-term economic growth.” Rosalind Wilson, president of the Canadian Chamber of Commerce, echoed these sentiments last year: “The strength of the Mexican economic system makes the country a favorite destination for Canadian investment.”

B. The Near-Sourcing Trend and Advanced Manufacturing in Mexico

Much of the growing interest in Mexico can be attributed to the global near-sourcing trend. There has been a shift in off-shore production strategies from one that focuses heavily on low labor costs to one that puts more emphasis on geographic proximity.

The **near-sourcing (or near-shoring) trend** is the result of a number of factors, but is attributable primarily to the rising cost of freight which is expected to remain high into the foreseeable future. Low-cost fuel made transportation costs negligible and for many years allowed manufacturers to locate operations in the lowest-wage countries. But as fuel prices rose from 15% of a carrier’s operating costs to 40%, the dynamics changed. CIBC World Markets reported that the transportation cost of Asian imports to the United States is roughly the same as imposing a 9% tariff. Consequently, companies are re-evaluating the cost-benefit calculations of their outsourcing policies and finding that staying closer to home is often the right decision.

This trend clearly favors Mexico. The ability to **move goods from Mexico to the U.S. in a matter of days by rail or truck**, versus a matter of weeks from Asian ports, is a tremendous advantage for many types of manufacturers. In addition, the ability to communicate and do business in the same time zone is often of vital importance. Unlike their counterparts in Asia, Mexican managers can communicate with U.S. headquarters and often resolve issues in the same day.

According to a quarterly report from AMR Research—a consulting firm from Boston—buyers will increase their near-shore sourcing and manufacturing activities by a ratio of 5 to 1. The report goes on to state that: “**Mexico is the preferred near-shoring destination**, with 84% of the respondents choosing it as a place for sourcing or manufacturing, followed by Canada at 55% and Brazil at 49%.”

Mexico is very committed to free trade. Besides NAFTA, the country has trade agreements with many other countries including Japan, the European Union and various Latin American countries with which the U.S. has no free trade agreement. As a result, qualifying products made in Mexico can be exported to these countries under preferential tariff rates.

With over 100 million predominantly young residents, Mexico's domestic market is also large and growing. Annual automobile sales in Mexico almost doubled from 1999 to 2008. And demand for durable consumer goods is expected to increase as young people start families and purchase homes. Whirlpool, for example, is currently experiencing a boom in domestic refrigerator sales.

C. Labor Cost Realignment

Mexico is also benefitting from rising labor costs in China. For over a decade, China has seen double digit GDP growth and rising productivity, which have increased labor costs in real terms. Inevitably, higher wages must be offered to attract Chinese workers. Honda and other manufacturers have recently been forced to raise salaries to deal with labor problems caused largely by the increasingly high cost of living in China. In addition, **the Chinese currency is appreciating against the dollar**. Despite a 20% increase to date, many leading economists believe the Chinese currency remains seriously under-valued. In some industrial sectors, Mexico is already the lower cost alternative.

Cost to produce an aluminum auto part

	2005	2008
China	\$17	\$25
Mexico	\$18	\$20
U.S.	\$24	\$29

Source: Business Week, Alix Partners

In contrast, as a result of the integration of the U.S. and Mexican economies, most economists expect the peso-dollar value to remain very stable. Signs of these linkages became apparent this year. Shortly after the economic crisis, there was a global flight to the dollar as the safe haven currency which briefly drove the peso-dollar exchange to nearly 16 to 1. Since then the peso has stabilized and returned to a rate approaching 12 to 1 as of the date of this report.

D. The Focus on Infrastructure Improvements

Infrastructure continues to be Mexico's Achilles heel, however, the situation is about to change. The government has launched a **massive \$141 billion five-year National Infrastructure Project (NIP)** to bring Mexico to the world's top 20 in terms of infrastructure development. In the near term, these projects will also create thousands of new jobs. There are over 300 individual projects included within the NIP relating to a variety of industrial sectors including energy, environment, transportation, telecommunications, security and tourism.

In terms of transportation, the investment, both public and private, will be channeled into ports, highways, border crossings, railroads and airports. More than 20,000 km of highways and rural roads are slated for improvement and modernization. The NIP also includes highway maintenance programs designed such that 90% of existing roads and highways will soon meet international standards. The rail system will be expanded by almost 1,500 km. Pacific and Gulf Coast ports, including Manzanillo, Lázaro Cárdenas and Veracruz will undergo major expansion projects to increase capacity for containers as well as bulk materials and roll-on/roll-off cargo. In addition, at least three new airports will be built and existing terminals will be expanded

The importance of infrastructure development cannot be over-stated. The ability to move products among NAFTA countries and beyond in an efficient and cost-effective manner is of vital importance to Mexico's competitive position. AMERICAN CHAMBER/MEXICO is heavily involved in efforts to improve transportation and logistics especially as it relates to streamlining customs and inspection procedures at border crossings.

E. Labor Force Availability, Quality and Affinity

According to a recent study by the Boston Consulting Group (BCG), a number of foreign companies are already enjoying the advantages offered by Mexico, especially in connection with advanced manufacturing activities. One of the key reasons has to do with the Mexican labor market.

First, as mentioned above, Mexican labor costs are approaching parity with Chinese labor rates according to the same BCG study. By the end of 2010, it is expected that **average wages in Mexico will be at 120% of Chinese labor costs, down from 200% in 2008**. With the continued appreciation of the Yuan, Mexico will become the lower labor cost country. Second, the labor pool is large and young. **Over half of the Mexican population is under the age of 35**.

Third, there is an abundance of managers with an excellent command of English, many having been educated in the U.S. With 15 years of experience under NAFTA, Mexican managers have become very familiar with U.S. business and management practices. Moreover, **most of Mexico is in the Central Time Zone**. Consequently, the time difference with the U.S., if there is one at all, is negligible. In contrast, the time zone change with China is 12 hours making same-day communications very inconvenient. The ability to have face-to-face meetings is also greatly facilitated. There are direct five-hour flights from New York to Mexico City, making it closer than Los Angeles.

Finally, **Mexicans have a Western point of view on cultural matters** very similar to the U.S. The values and interests of Mexicans—family, religion, personal growth, sports, etc.—track very closely with those of most of their northern neighbors. These similarities help foster a spirit of trust and cooperation which leads to stronger and lasting business relationships.

F. Investment Protection under NAFTA

One of the most innovative features of NAFTA is the creation of a dispute resolution system designed to protect foreign investors. Country risk is a key concern for most foreign investors especially in countries with still maturing domestic legal systems.

An entire chapter was included in NAFTA specifically to deal with the traditional problems arising under international law when a private foreign investor has a claim against the host government. If a government, at any level, takes actions or refuses to act when required to do so and, as a result, the value of an investment is impaired, the foreign investor may seek a resolution using a private arbitration process. These arbitration panels have already been used by investors

to obtain compensation for losses caused by various regulatory decisions that have impaired foreign investments.

G. Reform Agenda Supported by AMERICAN CHAMBER/MEXICO

Economic growth, prosperity and job opportunities are critical to Mexico's efforts to reduce crime. While progress has been made, Mexico is working on a number of initiatives to enhance competitiveness and spur economic growth.

Especially as it relates to foreign direct investment, the protection of intellectual property rights is critical. Mexico has taken **aggressive steps to protect intellectual property** in addition to the protection contained in NAFTA. While much remains to be done, the Mexican government understands the relationship between IP protection and foreign direct investment, and will continue to move aggressively to provide it. Apart from protecting foreign IP, Mexico is becoming a creator of intellectual property and, therefore, has a vested interest in making sure that it is protected.

Mexico is also attempting to reform its tax code to broaden the tax base and reduce its dependence on oil revenues which currently represent over a third of the federal budget. The Mexican private sector is pushing hard for changes in employment laws to make the labor market more flexible and dynamic which would lead to more job opportunities especially for lower skilled and younger workers. The government, supported by various NGO's, is also working to improve the public education system. Mexico already enjoys a high literacy rate, but more advanced skills will be needed to fill positions in increasingly sophisticated manufacturing processes and the growing services sector.

The status quo always has its defenders and these proposed reforms have met with resistance. However, the recent global economic crisis may actually serve as a wake-up call to government officials concerning the need to enhance competitiveness. AMERICAN CHAMBER/MEXICO will continue to support reform efforts designed to improve Mexico's overall business environment, enhance the country's competitiveness, and that will generate economic growth and jobs.

V. What Remains to be Done

A. *The Debilitating Influence of Drug Proceeds and Organized Crime*

There is a serious debate taking place within Mexico concerning the government's decision to confront drug trafficking. The discussion is focused largely on both the need for the policy shift and on whether the efforts can realistically lead to success, especially if the U.S. demand for drugs remains high. Several commentators have called it a war of choice rather than necessity.

The Mexican people are 10 years into the arduous process of creating a stable, multi-party democracy. While the notion that Mexico is at risk of becoming a failed state is non-sense—as evidenced by robust growth in foreign direct investment—certain government functions may be at risk of being controlled by organized crime syndicates. As would be expected, the police, the prosecutors, the courts and penal system are the primary targets for control and cooptation. To the extent organized crime syndicates could operate with little fear of being captured and prosecuted, or of having their money and assets seized, they are free to expand their business network.

The sums of money involved are staggering. Some estimates put illegal drug exports alone as a \$40 billion business which would place it behind only automobiles and oil on the list of exports by value from Mexico to the United States. But the Mexican cartels are neither revolutionaries nor terrorists. Their only ideology is the accumulation of money and the power needed to acquire and protect that money. They are not interested in changing the existing political structure but rather in exercising control over those aspects of the criminal justice system that specifically affect their operations.

If the criminal activities were limited to the transportation of drugs to supply consumers, perhaps one could argue that this is a victimless crime pairing

willing buyers with willing sellers and that the proper policy response should be focused on trying to curb demand. But this argument misses the larger picture. Organized crime syndicates, like most businesses, are not content to limit their economic activities when other profit opportunities are available. And to the extent control of the State's prosecutorial apparatus could ultimately be secured, the door would be left open for other lucrative and much less benign criminal activities that would ultimately have a debilitating impact on society.

B. *What Mexico Should Do*

At its core, the campaign against drug trafficking and organized crime is an **effort to create a country free of corruption and guided by the rule of law.**

“The Government and people of Mexico have shown tremendous bravery in carrying this program (Mérida Initiative) forward, despite substantial reprisals from the cartels. We believe that the Mexican Government's efforts are having a real impact; for the first time, trafficking organizations are facing an existential threat from the state, which they cannot win by bribery or intimidation.”

International Narcotics Control Strategy Report 2010, Bureau for International Narcotics and Law Enforcement Affairs. U.S. Department of State. March 1, 2010.

While many Mexicans are increasingly frustrated by the rate of progress, very few would disagree with the goals of transparency, honesty and efficacy for all governmental institutions.

Moreover, there are successful models in other countries from which Mexico can learn. Italy, Colombia and even the United States were able to effectively neuter the impact of organized crime on civil society and government institutions.

Unfortunately, the burgeoning middle class remains effectively closed to vast segments of Mexican society. In Ciudad Juárez, for example, it is estimated that 40% of youths are not in school or lawfully employed. Simply put, right now organized crime offers one of the most tempting opportunities for economic and social gain for the disaffected sectors of the population.

Mexico needs a much better education system including the opportunity for technical and vocational training. It needs programs designed to channel at-risk young people away from organized crime. Also, it needs a robust, growing economy able to absorb and adequately compensate the thousands of young people coming

into the job market every year. As mentioned, Mexico is already committed to a large-scale infrastructure program that will bring tremendous economic benefits to the country.

Mexico must also **focus on improving its system of law enforcement**. It is estimated that less than 2% of crimes lead to an arrest and prosecution. The police, prosecutors and courts must be modernized and professionalized so that crimes cannot be committed with impunity. In addition, Mexico must strengthen its ability to seize cash and other assets associated with criminal activity. At the same time, a certain amount of understanding should be shown to members of the Mexican police force, often earning \$500 per month or less. They have little incentive to take great personal risks against better equipped organized crime syndicates.

Fortunately, Mexican society understands that the current system cannot continue. And things are changing. In 2008 the Mexican constitution was amended to allow for open criminal trials in which evidence is presented orally to the court. This change will ensure a more open and much more efficient system of justice.

In addition, the centerpiece of the government's campaign to reshape law enforcement institutions is to **create a highly professionalized national police force**. Given the long history of corruption in Mexico, many experts agree that internal reform efforts are doomed to fail and that the only answer is a complete deconstruction and rebuilding. There will also be an emphasis on the **use of technology to track crime and criminals on a national level**. The commitment so far has been genuine. There have been hundreds of dismissals along with arrests and prosecutions of senior level officials, members of the police force and local politicians suspected of complicity with organized crime.

“We must do everything in our power to support our southern neighbors in the historic battle they are currently waging there against the cartels.”

Senator Joseph Lieberman, Chairman, Homeland Security and Governmental Affairs Committee, U.S. Senate. April 20, 2010.

C. What the U.S. Should Do

U.S. Secretary of State Clinton was correct when she remarked that “Our insatiable demand for illegal drugs fuels the drug trade. Our inability to prevent the weapons from being illegally smuggled across the border to arm these criminals causes the deaths of police officers, soldiers and civilians.” The U.S. is part of the problem and must be part of the solution.

First, the U.S. should ramp up its efforts to **reduce American demand for illegal drugs**. The White House Office of National Drug Control Policy announced recently that it will look for more funding aimed at drug use prevention and treatment. It is a step in the right direction but more needs to be done on the U.S. side of the border.

Second, **Mexico needs financial resources, technology and training**. The U.S. can provide all three. It can start by disbursing \$900 million from the Mérida Initiative and continue by adding to that amount. Fortunately, the Obama administration seems to be moving in this direction.

The Mérida Initiative contemplates a wide variety of programs aimed at anti-money laundering efforts, improving the Mexican judicial and correctional systems, reducing corruption, and interdicting weapons and cash flowing into Mexico, among many others.

It is in the United States' interest that Mexico succeeds in its fight against organized crime and more broadly in its efforts to generate greater economic growth. Mexico is the United States' third largest trading partner. Growth in the Mexican economy will translate into more U.S. exports and jobs in the United States.

There is also a clear trend toward regionalization in global trade. In order to compete, countries increasingly need to be part of a larger, integrated regional economy. NAFTA serves this need. Together, **the U.S., Mexico and Canada can compete globally** offering regional prosperity, jobs and investment. Simply put, Mexico and Canada are U.S. natural partners for manufacturing and trade.

VI. Conclusion

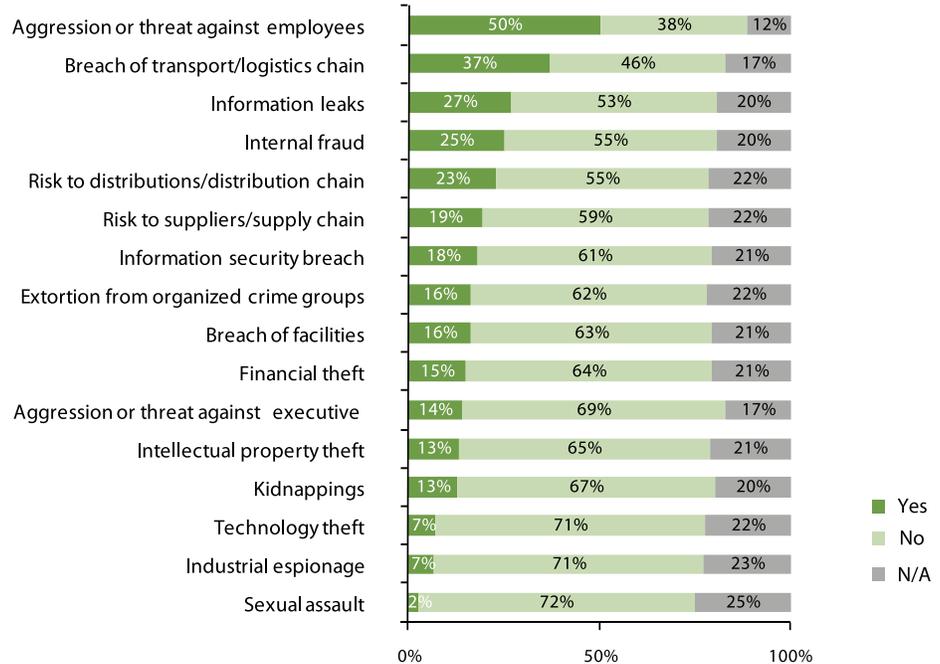
AMERICAN CHAMBER/MEXICO can attest to the fact that Mexico remains a country where it is safe to invest and where there are very good business opportunities. **Mexico is in fact a highly stable country both economically and socially.** That being said, there are security and crime threats that AMCHAM members have reported in our most recent security survey:

Although kidnappings for ransom or threats against executives are perceived to be widespread in Mexico, AMCHAM members rank the threat of their occurrence as among the lowest of existing security risks. Even those members who live and work in the relatively few regions most widely affected by drug trafficking rarely witness the events so extensively reported in the media. These criminal activities are, in some cases, the work of drug cartels looking to expand their business and in other cases, simply the work of common criminals.

The Mexican government is responding to the problems aggressively; these efforts must continue. In addition, as the primary consumer of drugs and supplier of weapons, the U.S. should be part of the solution and can help by providing adequate funding and technological support, as well as, by working to reduce the internal demand for narcotics and stopping the export of weapons. Mexico should also **push forward with various economic and political reforms** that will improve the country's competitive position fueling the economic growth.

Despite the current problems and challenges, **Mexico's economy is growing again.** After a brief pause due to the global economic crisis, foreign investment in productive and retail capacity is again flowing into the country. Mexico is generating more and more domestic demand for products and is poised to benefit from the near-sourcing trend that is causing global manufacturers to invest in plant capacity closer to the final market to overcome ever higher transportation costs and logistics issues, not to mention the benefits of managing in the same time zone. This tendency will continue especially as the China-Mexico labor-rate differential disappears.

Occurance of certain threats within companies in 2009



Source: AMERICAN CHAMBER/MEXICO Security Survey 2010

AMERICAN CHAMBER/MEXICO is convinced that prosperity and an abundance of good jobs are the most effective long-term solutions to Mexico's problems.

APPENDIX

All research was done between April 24th and May 21st, 2010.

References:

- Automotive manufacturing industry. (2009, November 18). US Commercial Service, Retrieved from: http://www.buyusa.gov/mexico/en/automotive_manufacturing.html#_section8
- Bremer, C. (2010, March 5). Factbox – Key political risks to watch in Mexico. *Banderas News*, Retrieved from: <http://www.banderasnews.com/1003/edat-riskstowatch.htm>
- Buchanan, R. (2010, March 31). Mexico's foreign investment: Business unfazed by Bloodshed. *Banderas News*, Retrieved from: <http://www.banderasnews.com/1003/nz-bizunfazed.htm>
- Cifras 10 años 2008/Cifras históricas, Venta de vehículos por entidad federativa. (2008). Asociación Mexicana de Distribuidores de Automotores, A.C., Retrieved from: <http://www.amda.org.mx/Cifras-10-Anos/>
- Country comparison – Area. (2010). Central Intelligence Agency (CIA), *The World Factbook*, Retrieved from: <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2147rank.html?countryName=Mexico&countryCode=mx®ionCode=na&rank=15>
- Country information: Mexico. (2010, May). Export Development Canada, Retrieved from: http://www.edc.ca/english/docs/GMexico_e.pdf
- Dutton, G. (2008, February 2). Mexico near-sourcing grows more attractive. *World Trade Magazine*, Retrieved from: http://www.worldtrademag.com/Articles/Feature_Article/BNP_GUID_9-5-2006_A_1000000000000249307
- Felbab-Brown, V. (2009, March). The Violent drug market in Mexico and lessons from Colombia. *The Brookings Institution, Foreign Policy Paper Series*, (13), Retrieved from: http://www.brookings.edu/papers/2009/03_mexico_drug_market_felbabbrown.aspx
- Galán, V, & Duarte, E. (2009, November 3). U.S. dumps China for Mexico. *Cable News Network (CNN)*, Retrieved from: http://money.cnn.com/2009/11/03/news/international/US_dumps_china_for_mexico/index.htm
- Hanson, S. (2008, November 20). Mexico's drug war. *Council on Foreign Relations*, Retrieved from: <http://www.cfr.org/publication/13689/>
- In-sourcing and China plus one: Who's going to Mexico?. (2008, August). *The China Sourcing Blog*, Retrieved from: <http://www.chinasourcingblog.org/2008/08/insourcing-and-china-plus-one-1.html>
- Índice de incidencia delictiva y violencia 2009. (2009, August). Centro de Investigación para el Desarrollo, A.C. (CIDAC), Retrieved from: <http://www.cidac.org/vnm/pdf/pdf/IncidenciaDelictivaViolencia2009.pdf>
- Kellner, T. (2009, April 8). The Forever drug war: Inside the Mexican drug wars quickly consuming a nation. *The Huffington Post*, Retrieved from: http://www.huffingtonpost.com/tomas-kellner/the-forever-drug-war-insi_b_531005.html
- Mexico at a glance, extraditions. (2009, June). US Embassy Mexico City, Department of Justice, Retrieved from: http://www.usembassy-mexico.gov/satag glance_extraditions.pdf
- Mexico: Business is standing its ground. (2009, April). *Business Week*, Retrieved from: <http://www.promexico.gob.mx/work/sites/Promexico/resources/LocalContent/1092/2/businessweek.pdf>
- Mexico-U.S. relations: Issues for Congress. (2009, May 1). Federation of American Scientists (FAS), Congressional Research Service, Retrieved from: <http://www.fas.org/sgp/crs/row/RL32724.pdf>
- Mexico's evolving sweet spot in the globalization landscape. (2009, July). *ProMéxico Inversión y Comercio*, Retrieved from: http://www.promexico.gob.mx/work/sites/Promexico/resources/LocalContent/1092/2/boston_consulting.pdf
- Phillips, S. (2008, August 22). IMF country analysis, Mexico: Building on reforms to tap full potential. *International Monetary Fund*, Retrieved from: <http://www.imf.org/external/pubs/ft/survey/so/2008/CAR082208A.htm>
- Pope, B. (2007, October 15). Mexico reclaiming manufacturing status. *Ward's Auto*, Retrieved from: http://wardsauto.com/ar/mexico_manufacturing_status/
- Procurement opportunities: Mexico's national infrastructure program. (2009, December 3). US Commercial Service, Retrieved from: <http://www.buyusa.gov/mexico/en/infrastructure.html>
- Sales of vehicles in Mexico 2010. (2010). Asociación Mexicana de la Industria Automotriz, A.C. (AMIA), Retrieved from: <http://www.amia.com.mx/autoventapub.php>
- Semaforo delictivo. (2010, April). Gobierno del Estado de Nuevo León, Retrieved from: http://www.nl.gob.mx/pics/pages/pgj_estsemaforo_base/SemaforoDelictivoCompletoAbril2010.pdf
- Shister, N. (2009, April 2). Near-sourcing: The way forward. *World Trade Magazine*, Retrieved from: http://www.worldtrademag.com/Articles/Feature_Article/BNP_GUID_9-5-2006_A_1000000000000563176
- Thoughts on the Mexican economy at year's end. (2009, December). *Mexico Business Blog*, Retrieved from: <http://bdp-americas.com/blog/2009/12/thoughts-on-the-mexican-economy-at-years-end/>
- Walser, R. (2008, July 23). Mexico, drug cartels, and the Merida initiative: A fight we cannot afford to lose. *The Heritage Foundation*, Retrieved from: <http://www.heritage.org/Research/Reports/2008/07/Mexico-Drug-Cartels-and-the-Merida-Initiative-A-Fight-We-Cannot-Afford-to-Lose>



AMERICAN CHAMBER MEXICO

For a better business environment

AMERICAN CHAMBER OF COMMERCE OF MEXICO, A.C. is an independent nonprofit organization with no political affiliations founded 1917. Its mission is to promote trade and private investment between Mexico and the United States, and to represent the interests of U.S. companies in Mexico and of its members in general. For more information: www.amcham.org.mx

Published: June 2010

Copyright 2010 American Chamber of Commerce of Mexico. All rights reserved.

www.amcham.org.mx