Monarch News

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CEO's Executive Summary

Two highly controversial legislative proposals dominated our attention this past month: one would have reduced the Mexican central bank's autonomy and opened the door to money laundering in Mexico, and the second tightly regulates the activities of U.S. DEA agents on Mexican soil. Both drew sharp rebukes, but only the Bank of Mexico legislation was temporarily defeated, with final consideration of this reform postponed until early February. The new national security law passed on the final day of the congressional session, a very worrying development for U.S.-Mexico security cooperation.

In other key developments, following the electoral college vote in the United States, Mexican President Andrés Manuel López Obrador (AMLO) finally sent a congratulatory letter to U.S. President-Elect Joe Biden. Delivered on the same day as approval of the national security law, the letter's luke-warm and somewhat contradictory contents suggest the possibility of a return to a somewhat prickly bilateral relationship. At the same time, the replacement of Mexico's respected ambassador to the United States with one with little to no diplomatic experience raises questions about the weight AMLO places on this essential bilateral relationship.

In other domestic maters, final consideration of the outsourcing proposal we discussed last month was postponed until February. AMLO made significant changes to his economic team soon after the 2-year anniversary of his inauguration. And, in politics, Mexico's three main opposition parties agreed to form an electoral alliance in advance of the 2021 mid-term elections. While national and state-level polls continue to show an edge for AMLO's Morena party, this new alliance will give the opposition a much better chance to cut into Morena's legislative majority and to win several of the 15 governorships up for grabs in June.

I. The Bank of Mexico Law

On November 19, Ricardo Monreal, the leader of Morena in the Mexican Senate, quietly introduced legislation that would alter the rules of operation for Mexico's autonomous central bank, known as the Bank of Mexico (Banxico). It was approved by committee eight days later and was about to be approved by the full Senate the first week of December when Banxico Governor Alejandro Díaz de León intervened.

Díaz de León noted the problems with a bill that would oblige the central bank to buy surplus dollars that commercial banks cannot repatriate to the United States. By requiring Banxico to make these purchases, the law would undermine the central bank's broad, constitutionally-mandated autonomy to determine when and how its purchases foreign currency. Equally troubling, by forcing the central bank to buy dollars without question, the new law would create a new mechanism to launder illicitly obtained dollars. Further, should foreign governments conclude that the Bank of Mexico were laundering money, its ability to undertake foreign operations essential to its monetary mission would be threatened, as would the $61 billion flexible credit line Banxico has with the U.S. Federal Reserve.

Senator Monreal insists that the law is not intended to undermine the autonomy of the central bank or create a new avenue for money laundering. He argues that it is instead designed to ensure that remittance receivers can easily and cheaply change their dollars for pesos at any Mexican bank. The problem with this argument, however, is that less than 1% of the nearly $40 billion in remittances Mexicans receive each year arrive as cash – the rest arrive via electronic transfers or through the banking system. Plus, the new law does nothing to reduce the fees migrants pay to send their remittances home.

Díaz de León's intervention delayed the bill but did not derail it. The full Senate approved the proposed law on December 9 and sent it to the Chamber of Deputies for approval during the final days of their fall session, which ended December 15. Meanwhile, AMLO telegraphed his approval of the proposal by stating that if the bill were to pass, he would have to respect it.

This set off an avalanche of criticism of the proposal, from economists and economic analysts, the Mexican Bankers Association, the Business Coordinating Council (CCE), and, potentially most important, from the two members of the Bank of Mexico board nominated by President López Obrador, Jonathan Heath and Gerardo Esquivel. Under this pressure, and following a meeting with Díaz de León on December 11, the Hacienda (Treasury) Committee of the Chamber of Deputies suggested postponing final consideration of the bill until February. Monreal echoed this position in a social media video two days later, and insisted that he was not opposed the Chamber of Deputies making changes to the proposed legislation.

Nevertheless, as if to send a message to the Bank of Mexico and the broader financial community as to who is in charge, the bill appeared on the agenda during the Chamber of Deputies' final session of the year on December 15. Only at the last minute, after Moody's suggested the legislation could hurt Mexico's sovereign credit rating and after reports of concern expressed by the U.S. Treasury, did legislators agree to table the bill until early February to allow for three weeks of negotiations in January to find a better way to resolve the surplus dollars problem. And only after this agreement did Mexico's Treasury Minister Arturo Herrera finally comment on the bill, and then only to express support for the decision to discuss it further in January.

Given the profound economic consequences of this bill for Mexico, and its dubious constitutionality (which the Bank of Mexico has said it will challenge), support for it is superficially puzzling. There are two potential explanations for the government's determination to push forward this change, both of which are disconcerting. First and most troubling, the government could be testing the waters to see to what extent it can get away with limiting Banxico's autonomy. AMLO has aggressively undermined the independence of many of Mexico's autonomous institutions, and he chaffes at his lack of control over Mexico's remaining autonomous entities, the Bank of Mexico being one of the most important.

Second and more immediately, the bill is likely a form of concession to Ricardo Salinas Pliego, the billionaire owner of multiple companies, including Banco Azteca. Salinas Pliego is on AMLO's Business Advisory Council, and Banco Azteca works closely with the AMLO government, including playing a central role in distributing the benefits provided to recipients of government social programs. Azteca is one of the largest recipients of cash remittences in the country and, more importantly, it lacks a correspondent banking relationship with a U.S. partner that would enable it to repatriate its surplus dollars. It was deprived of this in 2017 after its partner, Lone Star Bank, was fined $2 million by the U.S. government for transactions with Azteca that violated U.S. anti-money laundering statutes.

It is unclear how much the AMLO administration and its legislative allies will cede during the January negotiations, even though the Bank of Mexico has presented less costly solutions to the problems the bill purports to address. What is evident, however, is the new approach to governing embodied in this and the outsourcing legislation discussed below: rush legislation representing an extreme position through the Congress, pausing this process at the very last moment to negotiate with the interested parties. This approach allows the government to negotiate with the private sector from a position of strength that should improve its ability to achieve its preferred outcome.

II. National Security Law and U.S.-Mexico Relations

A second highly controversial legislative action taken in early December was the rapid approval of a new National Security Law that promises to disrupt security cooperation between Mexico and the United States. This bill was introduced directly by President López Obrador in the wake of the U.S. arrest and ensuing extradiction of former Mexican defense minister, General Salvador Cienfuegos. It is designed to show the United States that Mexico will not be disrespected or pushed around by its more powerful northern neighbor.

The new law denies immunity from criminal prosecution to foreign agents operating on Mexican soil, requires them to pass any information they uncover to Mexican authorities and to provide monthly reports on their activities to the foreign ministry, and obligates all Mexican government officials to report any communication they have with a foreign agent. These constraints are targeted directly at DEA and other U.S. law enforcement agencies and could cripple their investigative capabilities in Mexico. However, most analysts believe that the ultimate impact of this law will be to drive DEA activities underground.

Four days before final passage, U.S. Attorney General William Barr issued a curt but clear statement expressing U.S. consternation over this proposed legal change. He noted that the United States is "troubled" by legislation that would make "cooperation between our countries more difficult" and that will only benefit the "criminals that we are jointly fighting." After its passage, Senator Ted Cruz sent a strong letter to Barr and Secretary of State Mike Pompeo that accuses Mexico of "attacking" the DEA, "undermining" it, and potentially forcing the United States to reevaluate its relationship with Mexico. This was echoed in a message from Rep. Henry Cuellar expressing concern that the new law could jeopardize bilateral security cooperation. Cuellar, a Democrat from Texas, is one of the biggest champions of Mexico in Washington, and his criticism of the bill reflects the depth and the bipartisan nature of the concern in the U.S. with this new law. As if to emphasize the importance of bilateral security cooperation, the former Jalisco Governor, Aristotles Sandoval, was assassinated, presumably by organized crime, on December 18.

AMLO's long delayed congratulatory note to President-Elect Joe Biden did little to soften the blow of the security law. Arriving in Washington the day after the Electoral College vote (which AMLO argued was the culmination of the U.S. electoral process), its tone was luke-warm and its content somewhat contradictory. While appreciating Biden's support for Mexicans living in the United States and calling for good bilateral relations and collaboration, it makes clear AMLO's core objective for Mexico's relationship with the United States: Respect for Mexico's sovereign right to self-determination as it implements AMLO's Fourth Transformation suite of policies. Unfortunately, this objective risks direct conflict with U.S. national interests and stated Biden Administration policies in the areas of security, climate change, and potentially migration flows. On December 19, Biden received AMLO's congratulatory call which, according to the transition team's summary, appears to have been short and formal.

Finally, Mexico's respected ambassador to the United States, Martha Bárcena, resigned her post on December 14, the day of the Electoral College vote. Two days later, AMLO announced her replacement, the current education minister and close ally of businessman Carlos Salinas Pliego, Esteban Moctezuma. An economist with experience leading Mexican government agencies (he was Interior Minister and Secretary of Social Development under President Ernesto Zedillo in the 1990s), Moctezuma has no diplomatic experience or significant familiarity with the United States. As such, the nomination (that still must be authorized by the Mexican Senate and approved by the U.S. government) is somewhat surprising.

The rationale for choosing Moctezuma as Amb. Bárcena's replacement is unclear. Some speculate that AMLO wants an ambassador who is more attuned to his Fourth Transformation plans than to traditional foreign diplomacy, and as is often the case with AMLO's appointments, loyalty to this goal seems to have trumped preparation for the position. Whatever the reason, the new ambassador will face a steep learning curve at a moment when the bilateral relationship faces significant challenges and opportunities.

Monarch has enjoyed a strong, productive working relationship with Ambassador Bárcena, who, in our judgment, has been an honest broker, an effective advocate for Mexico, and a leader committed to strengthening the bilateral relationship. We wish her well in her future endeavors.

III. Economic Policy and Cabinet Changes

Returning to Mexican domestic policy, final consideration of the legislation regulating outsourcing that we discussed in our newsletter last month has been postponed until February. In the meantime, private sector and government representatives will continue their negotiations over its contents. This agreed upon delay does not reflect a softening of the administration's position, however. It instead amounts to a two-month reprieve in which the private sector can prepare for a new employment context in which outsourcing will be dramatically reduced and tightly regulated and illegality severely punished. Still to be negotiatied is how legally mandated profit-sharing will be impacted by the new employment legislation.

AMLO's motivation in pushing the legislation is to eliminate conduct that damages worker interests such as using outsourcing to evade social security taxes or profit-sharing, and, in the process, achieve AMLO's objective of better protecting labor in its relationship with capital. But the practices the government aims to eliminate are already illegal under Mexican labor law, so it is hard to see what this change will achieve beyond reducing flexibility in labor markets and further undermining business confidence in this government.

This outcome again highlights AMLO's new approach to governing, as noted above with regard to the Bank of Mexico law. While the approach may help the government advance its Fourth Transformation agenda, it is unlikely to build the confidence among investors, foreign and domestic, that is essential to revive investment and economic growth. This is the governing context that will greet the new members of AMLO's economic policy team.

Alfonso Romo departed as head of the Office of the President and AMLO's key liaison with the private sector in early December. Romo left the government on good terms, but he had clearly been frustrated. During Romo's two years in the administration, he was always able to express his opinions to the president, but his ultimate influence on major policy decisions – from the cancelation of the new airport to energy policy and most recently outsourcing – was limited. Romo's reduced importance to the administration was driven home by AMLO's decision to eliminate Romo's position in the Office of the President as an austerity measure rather than replace Romo.

Romo's role as liaison with the private sector will likely fall to AMLO's new economy minister, Tatiana Clouthier. Clouthier was AMLO's campaign manager and surprised everyone when she became a federal deputy rather than occupying a cabinet post during the first two years of AMLO's government. She now moves to center stage, but in doing so she is unlikely to bring any significant changes to economic policy. In part this reflects AMLO's extremely centralized decision-making style, but it also is due to Clouthier's lack of background on economic matters. She will have a steep learning curve in her new job. Clouthier was selected for this job because of her good relations with the private sector and her communication skills – her task will be to build greater understanding, and thereby gain greater acceptance, for AMLO's economic policies in the private sector and abroad.

AMLO's previous economy minister, Graciela Marquez, was approved by the Senate to become a new board member for the national statistics agency, INEGI, and she is expected to be elevated to lead the agency next year when the term of the current board president ends. This will place a well-trained economist – and AMLO loyalist – at the helm of Mexico's premier statistics agency.

AMLO also made his third nomination to the Bank of Mexico board. Serving as the federal treasurer since 2008, Galia Borja Gómez was the secretary of finance in the Mexico City government when AMLO was mayor and is considered a close ally of Finance Minister Arturo Herrera. She will be the second woman on Banxico's board, and the second time the treasurer has been elevated to this post. She is seen as a moderate whose addition to the board (she was easily confirmed by the Senate) is unlikely to change the current trajectory of monetary policy significantly.

The final change in the economic team is truly troubling: Elvira Concheiro will be the new treasurer. Rather than the technically trained profile that is demanded by a job that calls for ensuring that the government's fiscal income matches its spending, Concheiro is a sociologist trained in Marxist theory. It is unclear how she will be able to do the job effectively. Her main qualification appears to be her loyalty to AMLO, something that has raised concern during an election year.

At a moment when the COVID-19 virus is ravaging the Mexican economy as much as anywhere in the world, and when there has never been greater demand for and opportunity in bilateral cooperation on a North American economic agenda, the AMLO government shows little interest in positioning Mexico as a strategic partner to stage a significant economic recovery. The opportunities to bring manufacturing in critical sectors—especially in health care and other essential areas—back to North America by leveraging the NAFTA framework as enhanced by the USMCA is nowhere on the agenda. The selections for Mexico's new economic team and new representative in Washington as well as the lackluster response to the incoming U.S. administration all indicate little desire or intention on the part of the AMLO administration to change this.

IV. The Opposition Alliance

In domestic politics, Mexico's three main opposition parties – the PAN, PRI, and PRD – agreed to form an opposition alliance for the 2021 mid-term elections. They will field a single candidate in more than half of Mexico's 300 legislative districts and in nine of fifteen governors races. In addition, the political movement led by former President Felipe Calderón is about to rejoin the National Action Party (PAN), further reinforcing the opposition coalition.

According to two recent *El Financiero* polls, Morena has the advantage nationally and in 14 of the 15 states with gubernatorial elections. When the alliance is taken into account, however, the opposition becomes much more competitive. Morena is currently well-positioned to win a majority of the statehouses up for election (but more for local reasons than because of support for AMLO) and hold onto its legislative majority, but analysts believe that the size of this majority is apt to decline. All that being said, these elections are still five and a half months away and repeated studies have shown that campaigns matter in Mexico. This is something we will continue to watch closely.

V. Concluding Thoughts

2020 will go down as one of the most difficult and lethal years the world has faced. With the arrival of the COVID-19 vaccines, we look forward to a better and safe 2021 for all. The Monarch team wishes all of you, our friends and clients, a blessed and healthy holiday season, and we look forward to working with (and hopefully seeing!) you in the new year.

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