



Mexico: A Collapse Update

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I've been [predicting the collapse of the Mexican Nation-State](#) since 2006. It turns out that was a bit premature. But with violence flaring, the potential for collapse in Mexico is once again in the headlines. Oil production continues to fall, border violence is up, and the government is preparing for a showdown with the drug cartels. I'll argue below that the government will keep the wheels on through 2009, but that the Mexican state will collapse shortly thereafter, ushering in the beginning of the end of the Nation-State.

It's been difficult to read a paper or watch the news recently without hearing about the growing troubles in Mexico. The US military's Joint Forces Command issued their [Joint Operating Environment 2008](#) report recently that listed Mexico and Pakistan as the most likely states to collapse in the immediate future (PDF, see p.35 for analysis of Mexico). Even 60 minutes ran a segment about the rising drug violence.

Of course, readers are probably already aware that a root cause of the problems in Mexico is the [precipitous decline of Mexican oil production](#) and an even faster decline in the level of oil exports. Add to that declining remittance incomes being sent home by migrant workers in America, declining tourist revenues, and lower revenue per barrel of oil exported, and the Mexican state is experiencing a severe financial crunch.

While the fiscal stability of the Mexican state is impacted by continually declining oil production and oil exports that are declining even faster, this impact is mitigated to some extent because [PEMEX hedged the majority of its oil production through 2009](#) at roughly \$70/barrel. Depending on the price of oil in 2010, Mexican oil revenues stand to drop off a cliff as PEMEX loses hedge coverage.

Does this mean the Mexican state is finished? The current [crack-down by the Mexican military and federal police](#) is, I think, best seen as a last-ditch effort to save the state. But it is also evidence that, by the very existence of this pitched battle, the state retains enough viability to pose a threat, and therefore to be targeted.

In military theory, pitched battles are only consciously joined by both sides when both have an incentive to risk the main body of their force--either because they think they can win a decisive victory or because they are running out of the political, logistical, or economic ability to sustain their army in the field and must seek a decisive action while they can.

Clearly the drug cartels smell blood--and tactics like [forcing the resignation of the Juarez police chief by killing one or more police officers every 48 hours](#) demonstrate their desire for a decisive engagement. Additionally, the motivation behind a [recent truce among rival drug cartels](#) may be to facilitate a joint offensive against the government.

In my opinion, the Mexican government is seeking a pitched battle for the second reason—with their oil hedges only in place through 2009, and with oil production, remittance income, and [tourism dollars](#) poised to continue a sharp decline, the state may not have much more than a year of financial viability in which to cripple the drug cartels.

While a pitched battle may be politically expedient for the state, I think the cartels are too widespread and deeply ingrained to be defeated militarily. Salvation for the Mexican state will require regaining the long-term ability to compete with the cartels as a provider of social order and economic activity—something that cannot be gained on the battlefield. At a minimum, in order to finance its ongoing viability, the state needs significantly higher oil prices to increase export revenue or a rapid recovery in the US to generate an increase in remittance income. Given the current economic climate, the occurrence of both of these seems highly unlikely—there is simply no way of knowing where the tipping point lies, whether either one of these factors, or both, can save the Mexican state from eventual collapse. And without a renewed fiscal foundation, the eventual collapse of the Mexican state seems inevitable...

Impacts of Increasing Instability in Mexico

First, the increasing instability in Mexico will have a significant impact on PEMEX's ability to maintain the necessary levels of investment to minimize production declines. This creates a positive feedback-loop: faster declines mean more financial difficulties, more instability, and less investment, precipitating even faster declines. In 2009, [PEMEX plans capital expenditures of roughly \\$20 Billion](#). Traditionally, due to laws that prevent foreign ownership of many categories of natural resources, PEMEX has relied on debt to finance capital expenditures. More recently, PEMEX has also been pushing for a reform to the Mexican oil law that [would allow foreign companies an ownership stake in Mexican projects](#) in exchange for investment. Regardless of whether PEMEX pursues debt or equity financing, instability in Mexico's property rights regime—certainly including the potential for governmental collapse—will seriously hamper these efforts.

Certainly the impact of disintegration in Mexico will have an impact north of the border. There is already a clear [spill-over in criminal activity in border states](#). At some point, the national security threat to the United States will bring calls for intervention—but are there any effective options? The sprawling yet dense cities and mountainous rural terrain of Northern Mexico should give any military planners pause, especially in light of recent American experiences in Afghanistan and Iraq. That didn't stop President Obama and Admiral Mullen from [meeting yesterday](#) to discuss exactly these options. Some commentators have even suggested that Mexico, not Iraq or Russia or Afghanistan, will be the defining national security challenge of the Obama administration.

The potential impact on Mexican oil production seems clear. More superficially, the situation in Mexico gives [commentators of all stripes something to worry about](#). The spill-over of drug violence seems to preoccupy most mainstream talking-heads, but a few [commentators](#) have traced these problems back to their roots—and see a much more troubling threat. Specifically, the troubles in Mexico are an early sign of the failure of the Nation-State model. I've written about this extensively, and my intent here is not to re-hash my critique of the Nation-State system: if you're interested, [here's an academic paper on the topic](#). The key is that the trends pulling Mexico apart at the seams are ubiquitous—Mexico is merely facing this perfect storm first. As the Nation-State dominos begin to tumble next--Pakistan perhaps, then Iraq, then Russia, then Italy, then China, then Indonesia, etc.—the pressure on the rest will grow. And many of the most threatened states are also the most critical to global oil exports.

While I don't think Mexico—in its current form—has many years left, I hope I'm wrong. It's a beautiful country (especially if you can get outside the Americanized hotel zones), with a vibrant culture. It may even prosper in a post-peak world under some different form of social and political organization. And a token state-shell may last for decades (another global trend, I suspect)—after all, the cartels will probably be happy to delegate parts of the social contract to the “sovereign.” But, for all practical purposes, the Mexican state won't survive to see 2012.



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