

Violence and FDI in Mexico

The Economic Impact of the “War against Drugs”

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Finbarr O'Reilly/REUTERS

In general terms, violence impacts negatively on investment and a nation's economic growth. Nevertheless, this effect is not so clear in the case of Mexico. The economy seems to continue to grow despite the high levels of violence in recent years. This article analyzes recent trends in the flow of foreign direct investment (FDI) into Mexico, a variable with an important impact on the country's economic growth. This is why reviewing its behavior in recent years helps to better understand the economic effect of the extreme violence perpetrated by organized crime in the period of what has been called the “war against drugs.”

VIOLENCE, ORGANIZED CRIME, AND THE MEXICAN ECONOMY

The violence in Mexico has reached dizzying heights, particularly since Felipe Calderón Hinojosa's decision during his 2006-2012 administration to fight organized crime head on, bringing the armed forces into the fray in December 2006. The so-called “war on drugs” declared by Calderón contributed to the exponential growth of violence and resulted in the deaths of tens of thousands of people. By the end of September 2011, murders linked to this situation came to 45 515 according to official estimates.¹ This unprecedented spike in violence linked to organized crime has spread to various regions of the country, and is particularly significant in border states like Tamaulipas, Nuevo León, Coahuila, and Chihuahua.

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According to official figures, 34 612 people were murdered between December 2006 and December 31, 2010 (see Table 1). Official reports show a total of 2 826 homicides in 2007 and 15 273 in 2010.

The trends in violence levels and the geographic distribution of the conflicts throughout the country have changed in recent years. Previously, drug-trafficking-related violence was concentrated in border regions, particularly Chihuahua, and in Sinaloa, Michoacán, and Guerrero. Ciudad Juárez registered the highest number of homicides during the first four years of the Calderón administration: in 2010 alone, approximately 3 100 persons were murdered in that border city. More recently, however, the violence has spread to other regions of Mexico and intensified, particularly in the states of Coahuila, Nuevo León, and Tamaulipas.

There has also been an important change in the forms the violence has taken. Traditional execution-style killings among gangs of organized crime have begun to involve new forms of extreme violence and paramilitary-type practices, including decapitations, torture, dismemberment, and dissolving the bodies; kidnapping; and mass murder, among others. Hundreds of bodies buried in what have come to be called *narcofosas* (narco-graves) discovered in different points in the country, the *narcobloqueos* (narco-blockades), the hanging of *narcomantas* (narco-banners) sending messages to the government or to other organized crime groups, and the use of car-bombs and fragmentation grenades present a panorama never seen before, with decisive effects on society and the country's economy.

In a developing country like Mexico, analyzing the economic impact of violence becomes fundamental. Certainly, the new forms of organized crime and the clashes between government forces and criminal gangs have transformed economic relations in the country. They have also had important effects on the development of firms and foreign investment.

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However, the general trends of the economic impact are not visible at first glance, which is why a careful analysis of the situation becomes essential.

DRUG TRAFFICKING, VIOLENCE, AND ECONOMIC DEVELOPMENT

Different studies have been made analyzing the relationship between economic development and drug trafficking; or rather, the economic consequences of drug trafficking.² These studies identify this activity's costs and benefits. Some authors underscore the costs, which derive fundamentally from violence, corruption, and local drug use. In addition, violence generates important losses in FDI. On the other hand, there are those who maintain that the benefits to a country's economy (jobs and investments) are higher than the costs. Among the main benefits are job creation and the entry of cash and investments.

Journalist and economist Carlos Loret de Mola, for example, tries to use arithmetic deductions to calculate the effective weight of drug trafficking in the Mexican economy. He concludes that the economy would shrink almost 63 percent if this illegal activity were suddenly ended in the country.³ To the contrary, in a recent analysis, academic Viridiana Ríos argues that the illegal drug industry generates economic losses of almost US\$4.3 billion a year.⁴ Ríos carries

TABLE 1
HOMICIDES LINKED TO ORGANIZED CRIME (2006-2010)

	2006	2007	2008	2009	2010	Total
Mexico	62*	2 826	6 837	9 614	15 273	34 612

*Numbers for 2006 are only for the month of December.

Source: Secretaría de Economía (data from March 21, 2012), <http://www.economia.gob.mx/comunidad-negocios/competitividad-normatividad/inversion-extranjera-directa/estadistica-oficial-de-ied-en-mexico>, accessed August 8, 2012.

out a quantitative analysis and attempts to formally measure the net economic effects of Mexico's drug trafficking industry. This study considers "positive variables" like employment, cash flows, and investments generated by the drug trafficking industry. It also calculates the monetary "costs" of violence and corruption, the estimated losses in foreign investment, and the costs generated by local drug use.

So, it is not quite so clear whether drug trafficking is bad or good for the national economy in the aggregate. However, the moment Mexico is experiencing now makes us think that the economic costs exceed the benefits. The levels of violence and insecurity in the country today are extreme and are largely linked to the traffic of drugs, mainly aimed for the United States. In theory, this generates uncertainty, jeopardizes new investments, and produces unemployment. In effect, it is said that insecurity has a negative effect on FDI, affecting the country's image abroad and producing a negative impact on the factors of production and development; to all this is added an ineffective justice system.

DRUG TRAFFICKING, VIOLENCE, AND FDI

In the current context, we would expect organized crime to affect Mexican businesses, increase their costs, and have a negative impact on investments and the national economy. However, as I pointed out, at first glance, these effects do not seem to exist. This makes it necessary to carefully analyze investment flows and Mexican and foreign companies' development and strategies over recent years. In particular, it is interesting to look at the amounts of FDI, which has a significant impact on an economy's real growth.

It seems important to find out if there has been an exodus of foreign companies to other countries due to the extreme violence in Mexico. In theory, we might think that foreign investment in Mexico has not only not grown, but has decreased considerably. However, this "does not seem to be the case." FDI figures show no clear tendency to drop. The number of victims of the "war against drugs" continues to grow, but so does the economy. In 2011, GDP grew almost four percent.

FDI figures show that Mexico continues to be attractive. From 2006 to 2010, according to the Ministry of the Economy's National Registry of Foreign Investment, US\$115.58 billion came in.⁵ In 2010, the country saw a little over US\$20 billion in FDI, and in the first nine months of 2011, the amount had risen to US\$15.20 billion. That is, Mexico attracted ap-

proximately US\$19.55 billion in FDI in 2011, almost the same amount as the previous year (see Table 2 and Graph 1).⁶

In this context, political analyst Leo Zuckermann states, "We are still a long way from the US\$30 billion that entered in 2007, but what is coming in is not bad, considering the 2008-2009 recession, from which the world has not yet fully recovered. What sticks out in all of this is undoubtedly the foreign investment in the auto industry. Thanks to that, Mexico has become the world's 9th largest automobile producer, with an estimated output of 2.4 million units [in 2011], six percent more than in 2010. Important assemblers like Mazda, Honda, and Toyota have decided to build new plants in Mexico."⁷

According to BBVA Bancomer estimates, violence represents a cost to the country of approximately one percentage point of its annual economic growth. According to journalist David Luhnow of *The Wall Street Journal*, "In much of northern Mexico, businesses pay extortion taxes to drug gangs—a tax that hurts profits." Luhnow observes that the violence also makes transportation more expensive and represents additional security spending. He also says, "The bloodletting has also badly damaged the country's brand, leaving Mexico conspicuously absent from the fast-growing BRICS group of emerging market nations that comprises China, Brazil, Russia, India, and South Africa." However, according to Luhnow, "Fears that the violence would sink the broader [Mexican] economy have proved ungrounded, at least for now. Job creation has picked up steadily, consumer credit is expanding, and domestic sales of items such as cars and flat-screen television sets have grown at a double-digit clip" recently.⁸

Various analysts and public officials recognize that despite this violence, Mexico continues to grow and receive important sums of FDI. For example, economist José Juan Ruiz, the director of strategy and analysis for Latin America at Banco Santander, admitted that drug trafficking is "the fundamental threat" facing Mexico, but underlined that he has no information to demonstrate that "this scourge is scaring away foreign investors." Also, he explains that, in the short term, he

Analyzing the economic impact of violence is fundamental. The new forms of organized crime and the clashes between government forces and criminal gangs have transformed economic relations in the country.

TABLE 2
 FOREIGN DIRECT INVESTMENT (FDI) BY STATE (2006-2010)
 (MILLIONS OF DOLLARS)

	2006	2007	2008	2009	2010
Aguascalientes	113.1	206.4	39.1	99.6	39.2
Baja California	955.7	872.7	1 471.0	587.6	885.3
Baja California Sur	442.2	417.1	361.4	169.9	224.4
Campeche	10.6	13.5	-17.1	23.8	9.9
Chiapas	0.6	14.2	-25.2	1.1	2.1
Chihuahua	1 497.7	1 712.3	1 481.7	1 127.8	1 540.5
Coahuila	341.5	117.7	1 138.5	128.5	137.3
Colima	64.6	28.6	-1.3	21.2	3.4
Mexico City, Federal District	9 931.6	17 167.1	13 275.0	8 680.8	7 537.8
Durango	112.6	224.9	574.3	54.7	489.6
State of Mexico	1 341.4	755.9	1 596.7	1 543.4	1 050.8
Guanajuato	-70.7	260.0	270.7	119.3	112.1
Guerrero	26.8	-50.7	1.5	13.6	-53.3
Hidalgo	11.5	2.3	40.3	0.3	17.7
Jalisco	757.0	484.6	210.0	697.5	1 633.9
Michoacán	-110.0	1 590.3	31.9	28.5	3.3
Morelos	311.0	453.3	134.1	-56.3	17.0
Nayarit	159.0	81.7	23.8	50.2	52.4
Nuevo León	1 999.7	3 645.4	2 022.1	1 390.6	5 217.8
Oaxaca	10.7	15.2	17.7	29.2	5.3
Puebla	515.1	346.0	270.0	73.6	486.2
Querétaro	221.9	157.2	444.6	463.5	391.8
Quintana Roo	297.6	865.0	154.2	157.5	61.3
San Luis Potosí	96.2	191.2	141.7	-14.0	264.2
Sinaloa	47.1	41.2	44.6	17.4	21.3
Sonora	335.6	462.1	1 282.3	265.6	123.8
Tabasco	77.2	0.9	46.6	3.7	0.8
Tamaulipas	526.8	467.3	368.4	187.4	206.7
Tlaxcala	9.6	15.5	37.4	4.8	41.4
Veracruz	41.6	75.0	153.8	157.8	54.8
Yucatán	28.5	57.7	33.7	13.2	2.3
Zacatecas	15.4	801.0	1 517.0	77.5	127.5
Total	20 119.2	31 492.3	27 140.5	16 119.3	20 708.6

Source: Secretaría de Economía (data from March 21, 2012), <http://www.economia.gob.mx/comunidad-negocios/competitividad-normatividad/inversion-extranjera-directa/estadistica-oficial-de-ied-en-mexico>, accessed August 8, 2012.

The so-called “war on drugs” declared by Calderón contributed to the exponential growth of violence and resulted in the deaths of tens of thousands of people.

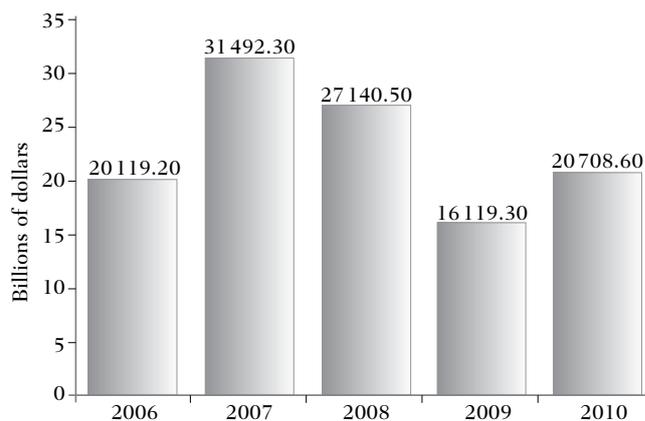
has not observed “any fall . . . in tolerance to investing in Latin America because of a perception of risk due to the drug trafficking, even in Mexico.”⁹

Carlos Guzmán Bofill, the general director of ProMéxico,¹⁰ for his part, states, “Despite the violence unleashed by the federal government’s war against drug trafficking, the global corporations see Mexico as a good place to do business.”¹¹ Former Minister of Finance Ernesto Cordero Arroyo denied that insecurity was affecting the economy’s performance. According to statements he made when he was a federal official, “There is no evidence that Mexico’s economic recovery is decelerating because of insecurity.” According to Cordero, investments continue to enter the country, creating jobs and companies.¹²

It is important to mention that evidence exists to substantiate these statements. Official statistics show that the flow of FDI to regions of the country with the highest levels of violence have increased or stayed the same over the last decade. According to Ministry of the Economy reports, “The amounts sent to the states that concentrated 70 percent of the homicides linked to organized crime were almost the same in the periods 2000-2005 and 2006-2010.”¹³ In this context, “the states along the border even increased their reception of international investments in the same period of comparison.”¹⁴ For example, Chihuahua and Tamaulipas are two of the states that have received the largest amounts of FDI. In July 2011, the Ministry of the Economy’s vice minister of competitiveness and norms, José Antonio Torre, stated, “From 2000 to 2005, Chihuahua, Baja California, Sonora, Tamaulipas, Coahuila, and Nuevo León were among the top 10 states to receive foreign direct investment nationwide, and this has continued to be the case in the last five years.”¹⁵

According to a report by Isabel Mayoral Jiménez in *CNN Expansión*, in 2010, “Mexico not only recuperated its attraction for foreign investors after the worst recession in its recent history, but increased it. This improvement is reflected in a higher demand for federal government peso-denominat-

GRAPH 1
FOREIGN DIRECT INVESTMENT (NATIONAL TOTAL)
(2006-2010)



Source: Secretaría de Economía (data from March 21, 2012), <http://www.economia.gob.mx/comunidad-negocios/competitividad-normatividad/inversion-extranjera-directa/estadistica-oficial-de-ied-en-mexico>, accessed August 8, 2012.

ed debt in the hands of foreign capital, and this entry of funds into the country made it possible to stabilize the exchange rate.”¹⁶ At the close of December 2011, “government securities in the hands of foreigners rose to Mex\$594.59 billion, of which 77.92 percent are concentrated in government bonds, a historic figure of Mex\$463.35 billion (the equivalent of approximately US\$37.50 billion), according to Bank of Mexico statistics.”¹⁷ In just one year, “The balance of foreign investment in bonds increased 60.21 percent, rising from Mex\$289.20 billion in December 2009 to Mex\$463.35 billion in December 2010.”¹⁸

Leo Zuckermann also stated, “Despite the violence, Mexico is attractive for setting up factories to produce manufactured goods for export.” In his opinion, “The devaluation of the peso during the 2008-2009 crisis made the national economy more competitive.” He also states that “increased wages in China’s manufacturing sector and the logistical problems for sending merchandise from China to North America” have also contributed.¹⁹

In 2010, the American Chamber of Commerce of Mexico (Amcham) carried out a survey called “The Impact of Security on Foreign Businesses in Mexico,” in which it asked 286 of its 2000 members for their perceptions and actions regarding insecurity in the country. It should be underlined that 60 percent of them said they felt less secure in 2009

According to BBVA Bancomer estimates, violence represents a cost to the country of approximately one percentage point of its annual economic growth.

than in 2008. Despite this increase in the feeling of insecurity, the survey concluded that “84 percent of member companies had plans to stay in business,” a quite solid, significant level.²⁰

To conclude, we can say that organized-crime-related violence has not scared away FDI completely. However, the country’s very delicate situation has affected the national economy in some areas, above all small businesses and border states. Therefore, it is necessary to go into more detail in the analysis of the country’s investments and economic situation, by size of firm, geographic region, and productive sector. This exercise is essential since we might encounter very important negative impacts in specific sectors of the population and areas of the economy that cannot be noted using aggregate statistics, which might be giving rise to an increasingly unequal distribution of wealth. ■■■

NOTES

¹ This is a figure given by the Federal Attorney General’s Office (PGR) on January 12, 2012. Other national sources stated that the so-called war against drugs has cost more than 60 000 human lives. For example, according to *Semanario Zeta* (The Z Weekly), the deaths linked to the violence unleashed by organized crime in the first five years of the Calderón administration came to 60 420. Other sources report higher figures. For example, Molly Molloy, a researcher at New Mexico State University, who also moderates the Google Groups discussion forum Frontera List, states that the current tally of murders related to the fight against drug trafficking “is much higher... almost double.” See Andrew O’Reilly, “Mexico’s Drug Death Toll Double What Reported, Expert Argues,” August 2012, <http://latino.foxnews.com/latino/news/2012/08/10/mexico-drug-death-toll-double-what-reported-expert-argues/>.

² See, for example, Office of National Drug Control Policy (ONDCP), *Drugs and Development* (Washington, D.C.: ONDCP, 1994), and *Economic and Social Consequences of Drug Abuse and Illicit Trafficking* (Washington, D.C.: ONDCP, 1998).

³ Carlos Loret de Mola, *El negocio: la economía de México atrapada por el narcotráfico* (Mexico City: Grijalbo, 2001).

⁴ Viridiana Ríos, “Evaluating the Economic Impact of Mexico’s Drug Trafficking Industry,” Spring 2008, http://www.gov.harvard.edu/files/Rios2008_MexicanDrugMarket.pdf. Despite this, the author recognizes that in certain small, less diversified rural communities, the flow of cash generated by activities linked to drug trafficking seems to help alleviate certain levels of poverty and underdevelopment.

⁵ In this period, there was an important drop in investment in 2009, which many explain citing the 2008 crisis, “since investment levels [were] still below their pre-economic shock levels.” This is consistent with the international situation. *CNN Expansión*, “Violencia no aleja inversión foránea: SE,” July 27, 2011, <http://www.cnnexpansion.com/economia/2011/07/27/crimen-no-espanta-a-la-ied-en-mexico-se>.

⁶ Secretaría de Economía, Dirección General de Inversión Extranjera (figures from March 21, 2012), <http://www.economia.gob>

[.mx/comunidad-negocios/competitividad-normatividad/inversion-extranjera-directa/estadistica-oficial-de-ied-en-mexico](http://www.economia.gob.mx/comunidad-negocios/competitividad-normatividad/inversion-extranjera-directa/estadistica-oficial-de-ied-en-mexico), accessed August 8, 2012.

⁷ Leo Zuckermann, “¿Afecta la violencia a la economía?” *Excelsior*, “Nacional” section (Mexico City), October 11, 2011, p. 4.

⁸ David Luhnow, “Mexico Economy Withstands Drug War,” *The Wall Street Journal*, November 22, 2011, <http://online.wsj.com/article/SB10001424052970203710704577054400522504414.html>.

⁹ Francisco Medina, “Narcotráfico golpea inversiones en México,” *El punto crítico*, February 22, 2011.

¹⁰ ProMéxico is a federal agency “charged with coordinating the strategies aimed at strengthening Mexico’s participation in the international economy, supporting exports by companies established in our country, and coordinating actions to attract foreign investment.” http://www.promexico.gob.mx/es_mx/promexico/Acerca_de_ProMexico.

¹¹ “Fluye inversión extranjera a pesar de violencia: ProMéxico,” *Proceso* (Mexico City), June 16, 2011.

¹² José Manuel Arteaga, “Cordero desdice a Banxico; inseguridad no afecta economía,” *El Universal* (Mexico City), June 2, 2011.

¹³ “Violencia no aleja inversión foránea: SE,” op. cit.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Isabel Mayoral Jiménez, “En 2010, extranjeros ganaron con México,” *CNN Expansión*, January 12, 2011, <http://www.cnnexpansion.com/economia/2011/01/11/mexico-recibe-inversion-recor-de-cartera>.

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ Leo Zuckermann, op. cit.

²⁰ Belén Zapata, “Gobiernos extranjeros hacen recomendaciones por inseguridad en México,” *CNN México*, February 9, 2011.