

Democratic Governance in Mexico: Beyond State Capture and Social Polarization

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PREFACE

The Institutional and Governance Review (IGR), entitled *Democratic Governance in Mexico: Beyond State Capture and Social Polarization*, was coordinated by Yasuhiko Matsuda (Sr. Public Sector Management Specialist) and Roby Senderowitsch (Sr. Social Scientist and Institutional Development Specialist). Team members included Phillip Keefer (Lead Economist), Alberto Leyton (Sr. Public Sector Specialist), Ana Bellver (Public Sector Management Specialist), Guadalupe Toscano (Public Sector Management Specialist), and Odracir Barquera (Analysis and Liaison). Specific inputs were provided by Arturo Alvarado, Javier Aparicio, Sigrid Arzt, Sabino Bastidas, Marcelo Bergman, Jorge Chabat, Felipe Hevia, Ernesto Isunza, Fabrice Lehoucq, Eric Magar, Alejandro Monsiváis and Vidal Romero.

This Report was produced in a highly participatory manner. A series of consultations were held with different Mexican experts and stakeholders, given their rich knowledge of political and institutional issues in Mexico. Also, workshops were carried out with the counterparts in the Office of Public Policy of the Office of the President of Mexico, which resulted in rich input to the design of the study and the production of the final document.

The team greatly benefited from the comments provided by Alain de Remes from the Office of Public Policy of the Office of the President of Mexico, who also accompanied the whole process and agreed to write the rejoinder that precedes the main body of the report; and by the peer reviewers: Steven Webb (Lead Evaluation Officer at the World Bank's Independent Evaluation Group), Stuti Khemani (Economist at the World Bank's Development Research Group), and Luis Rubio (President of CIDAC). Participants at the review meetings provided comments, including Gabriela Aguilar, Juan Carlos Alvarez, Dan Boyce, Mauricio Cuéllar, Joost Draaisma, Teresa Genta-Fons, Linn Hambergren, Gladys López-Acevedo, Ernesto May, Ron Myers and Fernando Rojas.

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“MEXICO BEYOND STATE CAPTURE AND SOCIAL POLARIZATION”

EXECUTIVE SUMMARY

Introduction

1. Mexico is in the midst of a transition. The defeat of the Revolutionary Institutional Party (PRI) in the 2000 presidential election marked a watershed, and with the repeated defeat of the PRI in the 2006 election, the era of the single-party dominance appears to be long gone. The demise of the one-party system may have been expected to usher in a new era where benefits of the government policies and economic development are more widely shared. But, such a change has yet to take place. Why not? At the same time, there is a strong perception that the pace of much-needed economic reforms slowed down under the new political arrangement. Why? This Institutional and Governance Review (IGR) addresses these crucial questions, and in so doing tries to offer some insights into how Mexico’s democratic governance may be strengthened over time. Taking into consideration the evidence collected for this work, the study argues that Mexico is well positioned to start its second transition towards effective democratic governance in the country, but to do so will require addressing certain socio-political obstacles that continue to limit the full effects of democratic accountability.

Incomplete Transition, Special Interest Politics, and the Challenge of Democratic Governance

2. As Mexico has shifted from a single-party regime to a multi-party democracy characterized by competitive elections, citizens are taking increasingly active roles in deciding the future of their society. The long-term dominance of a hegemonic party – characterized by high levels of political power concentration and meta-constitutional powers invested in the President – has been replaced with democratic institutions based on division and decentralization of powers and increased checks and balances. Political competition at all levels of government has resulted in party turnover and greater public access to government information, although the pace of progress varies between the federal and the sub-national levels and among the sub-national jurisdictions.

3. The increased salience of elections has expectedly led to a shift in the policy directions in some sectors. Thus, public spending in Mexico has generally become much more pro-poor, and the coverage of basic social services such as primary health care and basic education has improved since the early 1990s. Still the pending reform agenda is long, and the quality, equity, and effectiveness of basic public services such as public

health, education, and public security leave much room for improvement. Mexico's remaining policy challenges are not trivial.

4. In many ways, the remaining policy distortions are due to undue influence of interest groups such as some of the public sector labor unions and certain economic elites. These groups are mediating – and many times capturing – the relationship between the political leadership and the citizens in general (as voters) – affecting the provision of public goods and services. Their influence has been due in part to their own specific leverage over the policy making process, particularly the ability to strike or otherwise disrupt key state functions or sources of revenue, or the ability to buy politicians' allegiance with their financial clout.

5. Numerous examples of reform efforts since 2000 indicate that, despite the political pressures on politicians to appeal to voters broadly, a sign that a competitive democracy is emerging in Mexico, vested interests in many areas have continued to be an immovable obstacle to reform intended to deepen pro-poor social policies in Mexico. Chapter 2 presents several examples of this, including the partial reform of the social security program, the difficult reorganization of the education system, truncated fiscal efforts necessary for even more pro-poor policies, and the ineffective provision of public security. These groups had gained entrenched positions thanks to decades of privileged access to power, despite often not representing a majority's interests in their own segments. After the end of the political system that accorded them such privileges, these groups continue to take advantage of their positions and organizational capabilities to thwart those reforms that threaten their long-enjoyed privileges.

6. As documented in Chapter 3, pernicious presence of special interests is visible in the economic arena as well. Although the market-oriented reforms of the 1990s, such as trade liberalization, have brought many benefits to the Mexican economy, in some specific instances, these same reforms have yielded fewer results in terms of making Mexico more competitive. The most notable example is the privatization of the telecom sector, which merely replaced a public monopoly with a private monopoly. Market concentration, at least in some sectors, and the high level of wealth concentration work hand in hand to make Mexico's political playing field far from level. Economic power translates into political influence, and weakens the relative weight of an average voter preference in the political process.

7. In sum, our review of policy episodes in social and economic policy domains shows how, even in the more democratic environment, privileged abilities of special interests to exert their influence over policy content remain strong. Competitive elections have empowered ordinary citizens and increased their ability to stand up against special interest politics. But, the capacity of special interests to mobilize resistance outside of formal electoral and legislative arenas mitigates the accountability effects of elections. These resistances not only block or dilute reforms when they are attempted, but they naturally make politicians reluctant to take on ambitious reform

agenda, knowing the difficulty of overcoming special interest pressure. In turn, the voters can (rightly) grow skeptical of politicians' ability to overcome the resistance and choose to ask for tangible, particularistic benefits rather than fundamental reforms that can improve the country's general welfare in the long run.

The Alleged Case of Reform Deceleration and the Need for Political Reforms

8. Our analysis highlights the role of special interests in subverting democratic processes in Mexico and undermining the quality of public policies, be they more equitable provision of public health, more effective public education, or more efficient economic regulation. Of equal or perhaps even greater salience within the ongoing Mexican debate on governance challenges is the question about the efficacy of the Mexican state, arising from the inability of the government to pass pending structural reforms. A number of observers have pointed their fingers at institutional weaknesses of the Mexican state, especially the difficulties the executive branch has had in forging consensus to form a sufficient legislative coalition in Congress for passing reform bills. These observers have suggested a variety of so-called political reforms to change the contour of Mexico's constitutional design and either to give the executive greater political powers and clearer mandates (e.g., by switching to a parliamentary system) or to make politicians more responsive to voters (e.g., by eliminating the proportional representation voting system and adopting a US-style winner-take-all electoral system).

9. Constitutional reengineering is not a panacea, however, and international experience suggests a need for caution. Behavioral effects of institutional change are hardly predictable, and available empirical evidence shows very little effect of a particular institutional choice on the quality of policies (see Tables 4.7 and 4.8 in the main text). Indeed, empirical evidence is mixed regarding whether a particular feature of the current institutional configuration, divided government, is mainly responsible for slowing down structural reforms. The information on "legislative productivity" we have collected shows evidence of a slowdown in constitutional reforms, which are needed for some of the pending reforms such as a comprehensive reform of the petroleum sector. But it also shows that the number of federal laws passed (either anew or as revisions to existing laws) actually increased during the period of divided government because of the heightened legislative activities of the political parties (table 1).¹

¹ It is possible that the higher incidence of the passage of opposition-sponsored bills reflects the influence of the special interests that we highlight in this report, but to ascertain such an argument, a far more detailed analysis of individual bills is necessary. Such an exercise was beyond the scope of this study.

Table 1 Constitutional Reforms by Legislative Period, 1988 – 2006

Legislative Period	President	No. of Arts. Reformed/1	Avg. duration/2	Avg vote/3	% avg/4
1988-91 (54)	Salinas I	10	178	315.6	63%
1991-94 (55)	Salinas II	42	83	325.9	66%
1994-97 (56)	Zedillo I	54	124	396.6	79%
1997-00 (57)	Zedillo II	22	186	380.6	76%
2000-03 (58)	Fox I	13	565	399.8	80%
2003-06 (59)	Fox II	2	552	393.0	79%
		143	281	368.2	74%

1. Does not include transitory articles.

2. Average calendar days between the date of initial submission and publication in *Diario Oficial de la Federación*.

3. Requires two-thirds of the Lower House ($500 \times 2/3 = 334$).

4. Percentage does not take into account quorum in each session.

Source: *Gaceta Parlamentaria*, and <http://www.diputados.gob.mx/leyinfo/refcns/index.htm>.

10. If the same executive-legislative arrangement can produce a high frequency of legislative reforms, then it is unlikely that the reform paralysis is attributable to the presence of divided government. Moreover, the difficulty in passing reforms seems to be limited to certain policy domains where vested interests are particularly powerful. A cursory look at the frequency of federal law reforms in different policy areas, although not systematic, is illustrative of the overall pattern where certain sectors have proven resistant to reform throughout the last three *sexenios*. Table 2 shows that the federal laws governing the four contentious areas of structural reforms – energy/petroleum, pension, and labor – together have gone through far fewer changes than those related to other policy areas such as criminal justice and fiscal affairs. These tallies should be interpreted with caution. They offer no insight into the quality and the relative significance of the legal changes. Nonetheless, they do generally support the contention that these reforms have always been difficult even during the height of the reformist PRI presidencies.

Table 2 Reforms to Selected Federal Laws, 1988 – 2006

Laws with frequent reforms				
Sector	Law	Salinas	Zedillo	Fox
Criminal Justice	CÓDIGO PENAL FEDERAL	13	13	13
	CÓDIGO FEDERAL DE PROCEDIMIENTOS PENALES	8	9	9
Taxation*	LEY DEL IMPUESTO AL VALOR AGREGADO	7	8	12
	LEY DEL IMPUESTO ESPECIAL SOBRE PRODUCCIÓN Y SERVICIOS	6	8	7
	LEY DEL IMPUESTO SOBRE LA RENTA	-	-	11
Health	LEY GENERAL DE SALUD	1	3	22
	Total	35	41	74
Laws with limited reforms				
Energy	LEY DEL SERVICIO PÚBLICO DE ENERGÍA ELÉCTRICA	3	-	-
Petroleum	LEY REGLAMENTARIA DEL ART. 27 CONSTIT. EN EL RAMO DEL PETRÓLEO	-	2	2
Pensions	LEY DE LOS SISTEMAS DE AHORRO PARA EL RETIRO	-	4	4
Labor	LEY FEDERAL DE LOS TRABAJADORES AL SERVICIO DEL ESTADO, REGLAMENTARIA DEL APDO. B DEL ART. 123	-	1	1
	LEY FEDERAL DEL TRABAJO	-	1	1
	Total	3	8	8

Source: "Sumario de Reformas a las Leyes Federales Vigentes", Cámara de Diputado, Sep. 19, 2006 and Aparicio (2005).

* Selected tax laws for illustration only.

11. In sum, while the government's failure to pass the currently pending energy, labor and public sector pension reforms has been disappointing, it appears that the sources of these reform failures are not simply because of the presence of divided government. In fact, the inability to have these particular reforms enacted is not unique to the Fox administration. No previous administration, even at the height of PRI hegemony, was able to make significant headway with them, either. The vested interests that have blocked reform since 2000 seem to have been at least as influential prior to 2000.

12. On the basis of the evidence reviewed, we contend that the core of the governance problems in Mexico, in terms of both the demonstrated difficulty in

strengthening the state's capacity to provide public goods and passing contentious economic reforms, has its roots in the country's socio-political reality rather than in its institutional arrangements. Besides the role of special interests, the political polarization of the Mexican population so clearly demonstrated in the last presidential election is an aspect of this reality that is not directly due to Mexico's institutional arrangement. Therefore, we contend that the case for political reforms is weak in today's Mexican context not because political institutions are not important but because they do not seem to address fundamental causes of Mexico's governance challenges as we have identified in this study. We also argue political reforms should be approached with caution because their outcomes are inherently quite uncertain, while the political cost of a major state overhaul is necessarily high.

13. In a cross-country regression analysis reported in Chapter 4, we find that most variables related to specific political institutions fail to explain Mexico's policy performance vis-à-vis international comparators. In the same analysis, however, one variable shows up as statistically significant in explaining Mexico's performance in public spending and corruption. This is the degree of democratic consolidation, measured as the number of continuous years that a country has had competitive elections. Simply put, the more consolidated a democracy, the better the country's policy performance. To say that democratic consolidation improves governance is not to resign oneself to the view that Mexico simply has to wait for decades to see its political system mature. Specific measures can be taken to sharpen the beneficial effects of a key aspect of a mature democracy, competitive, issue-based elections, so that citizen voice influences government decision-making more effectively.

Obstacles to Full Electoral Accountability and Priorities for Reform

14. In Mexico, the role of special interests and the political polarization serve as countervailing factors that dampen effects of the competitive elections and limit the political parties' incentives to seek votes on the basis of their programmatic reputations. Aware of these challenges, this paper identifies a number of priority areas for attention from the point of view of strengthening Mexico's burgeoning democratic governance. The driving concern is to strengthen electoral accountability in Mexican politics so as to restrain the pervasive influence of special interest groups. We suggest that special interests' influence could be controlled with transparency measures that allow the general public to scrutinize their political behavior. Ultimately, however, relevant sectoral reforms, such as deepening of education decentralization or reduction in market concentration, would be necessary to disperse the political power currently concentrated in few hands.

15. A complementary set of reforms would be needed to strengthen electoral accountability of politicians. Here we advocate policy-based competition among well-institutionalized political parties as an ideal situation. For this, our suggestion is to consider lifting the electoral rule so peculiar to Mexico that prohibits legislators from

running for immediate reelection. Other possible reforms to the electoral system, such as to change the current mixed system to a single-member district system or to a proportional representation system, seem unlikely to effectuate desired results, that is, to encourage policy-based competition among well-institutionalized political parties. Combined with the above-mentioned transparency measures that focus citizen attention to substantive policy issues and government performance, the lifting of reelection ban may create incentives for political parties to seek votes (for reelections) on the basis of their good records in elected offices.

16. Increasing politicians' incentives to respond to citizen demand is only one side of the coin. The other side is to strengthen voters' own incentives to demand public goods as opposed to particularistic benefits. In this sense, addressing polarization is perhaps a higher priority in the short run. No amount of policy proposal will be taken as credible or sincere if the environment is so polarized and mistrust reigns. When policy proposals are not credible, voters will demand tangible, short-term benefits, and politicians will respond accordingly, thus leaving the political exchange between voters and politicians at low levels of policy equilibrium characterized by patronage and clientelism.

17. Policy credibility can only be built on the basis of an actual record of delivering good policies. But, even this becomes difficult when socio-political polarization pits one group of society against another. It then becomes necessary and highly important for the government to take measures to build credibility among those voters who sit on the opposite camp of the polarized political map, which seems to characterize Mexico today. One set of options would be to launch a visible program to strengthen statutory autonomy of a range of government institutions such as the civil service or the police force. For several reasons, granting independence to regulatory agencies within transparent public accountability arrangements might be a fitting entry point. If successful, such reforms could also contribute to the country's competitiveness agenda, and, especially for the current administration that is seen as business friendly, would send the signal to the population in general that the government is not captured by powerful business interests.²

18. Another critical theme would be strict adherence to the rule of law and concerted efforts to strengthen the country's legal and judicial institutions. This is obviously easier said than done, but the emphasis on the rule of law, together with the earlier point about transparency should form the backbone of the governing principle of the democratic Mexico, no matter who is in power.

² For purposes of this work, "state capture" is defined as the actions of individuals, groups or firms both in the public and private sector to influence the formation of laws, regulations, decrees and other government policies to their own advantage as a result of the illicit and non-transparent provision of private benefits to public officials (Hellman et al. 2000).

REJOINDER TO THE MEXICO INSTITUTIONAL AND GOVERNANCE REVIEW³

19. The Institutional and Governance Review (IGR) on Mexico undertaken by the World Bank is a sound and provoking project that will certainly ignite lively discussions among the Mexican public.

20. The core argument of the report conveys a clear message to the new administration headed by President Calderón: “Mexico should get rid of powerful interest groups and monopolies if it wants to improve governance, bolster democracy and achieve sustained growth.” This is certainly not a minor claim, if we consider that Mexico experienced one of its most competitive Presidential elections in history, and issues related to monopolies and interest groups were at the core of the campaign.

21. Another interesting aspect of this report is that it will become the first assessment of the Fox administration. The manuscript makes a thorough evaluation of how Mexico is performing under a democratic regime. The assessment is rather comprehensive and covers different subjects, such as how social and economic programs are working, and how democratic competition has brought both continuity and change in several facets of the Mexican political life.

22. However, this accurate and strong claim stating that Mexico needs to get rid of powerful interest groups and monopolies as the main problem for governance has the disadvantage of disregarding rather quickly the need to perform an institutional reform and constitutional re-engineering -- due to the inherent uncertainty in policy outcomes and the possible cost involved in a major constitutional redesign. Therefore, the study takes an extremely strong “structuralist” approach that seems to play down the need of going one step further in the institutional reforms.

23. Perhaps the quibble with this report is that it needs to explain in depth how these vested interests became so powerful over time. And this can only be done by conducting a thorough analysis of the type of institutions that were created during the 71 years of the PRI hegemony. Vested interests became powerful through a series of political concessions and through an institutional framework that allowed them to grow and consolidate themselves. This paradox is stated, albeit not fully developed, in several sections of the paper. Therefore, it is impossible to unlink the existence of powerful interest groups from the institutional context in which they were created.

³ This rejoinder was written by Alain de Remes, Advisor at the Office of Public Policy from the Office of the President, in November 2006.

24. What this paper also looks at, but in a very succinct way, is that institutions have consequences on the behavior of politicians. For example, the regression analysis makes a causal connection between type of regime and policy outcomes but disregards that there is an intervening mechanism called behavior of politicians which may alter the results. Thus, the paper could yield better policy recommendations if it presents the regression results between type of regime and policy outcomes as a first cut approach, and then discuss if some changes in the political system could alter the behavior of politicians in order to: 1) be more responsive to citizens; and 2) cooperate to undertake economic and social reforms that hinder special interests.

25. In a nutshell, a combined approach between structural and institutional arguments could yield more interesting policy recommendations, since Mexico needs to tackle both aspects simultaneously. Mexico needs to curb strong groups of interest, and this needs to be done by changing the institutional setting that comprises deepening some reforms and looking for ways to revamp some political, economic and societal institutions. Mexico needs to fix politics if it wants to have a functional democracy. A functional democracy refers to a framework where politicians have the right incentives to cooperate between parties and branches of government, and they also have the right motivation to work in the general interest of citizens, and not only for vested groups of interest.

26. The main point of reforming and creating new institutions should be to foster credible commitments among politicians in order to address the current polarization of the system. Even as suggested in the paper, strengthening the autonomy of a range of government institutions means a change and a re-engineering in the institutional design.

27. Concerning the recommendations, the report advocates the creation of independent institutions. However this solution is extremely costly, since independent institutions need specialized bureaucracies that require large amount of resources to operate. An alternative solution to insulated institutions would be to create balanced institutions where politicians from all parties share the responsibility for their creation and in their administration. This would mean that the solution is not having “less politics” by creating institutions under full control of citizens, but rather putting politics at work and balancing the forces within the institutional setting.

28. Finally, the IGR should emphasize more strongly that one of the key factors to improve governance is the rule of law. If Mexico wants to be successful in achieving better governance, it needs to take clear steps in this direction.

1. INCOMPLETE TRANSITION AND THE CHALLENGE OF DEMOCRATIC GOVERNANCE

“Lo viejo no acaba de morir y lo nuevo no termina de nacer”

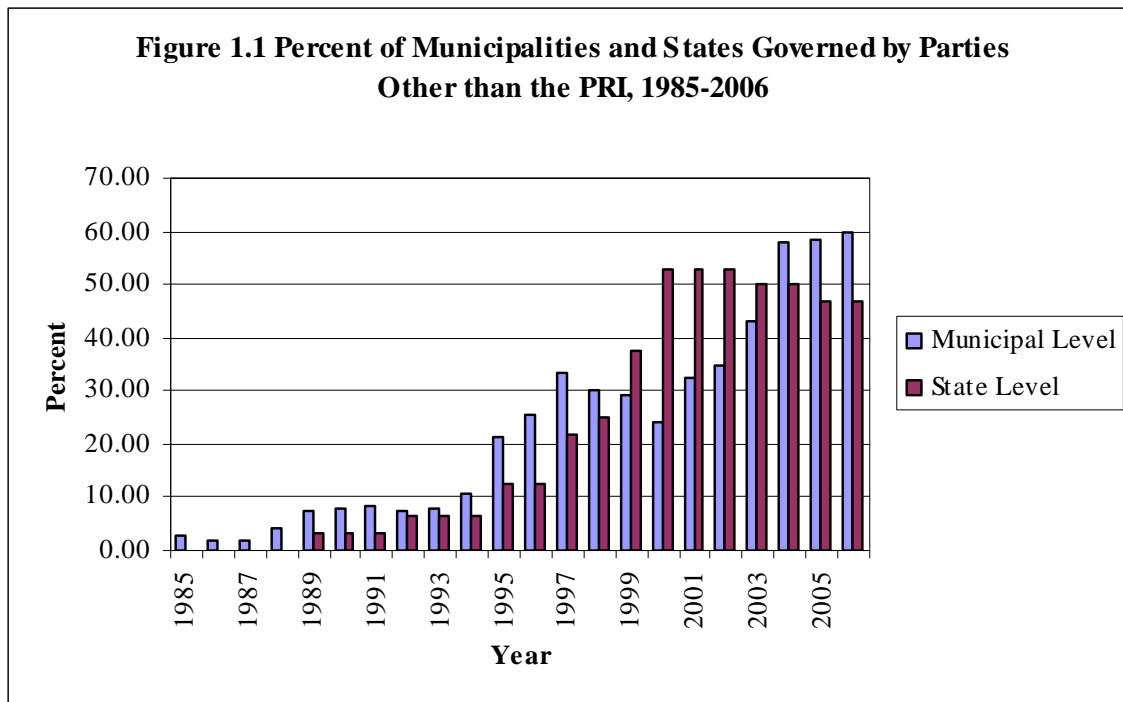
1.1 During the last two decades, Mexico saw a number of improvements and reforms, including expanded coverage of basic social services such as education and health to respectable levels. The macroeconomic and trade reforms in the 1990s have turned Mexico into a stable and open economy, and since the mid 1990s, the country has been going through a process of political opening accompanied by the strengthening of some of its core democratic institutions such as the judiciary and electoral institutions.

1.2 Still the pending agenda is long. The country’s growth performance is below its potential, and the quality, equity, and effectiveness of basic public services such as public health, education, and public security leave much room for improvement. Mexico’s remaining policy challenges are not trivial.

1.3 While a non-competitive economy and poor social services are common characteristics of a number of developing countries, what separates Mexico from other developing countries that suffer from similar policy ailments is their political and institutional roots. In a nutshell, many of the distortions observed in Mexico’s policy sectors result from the role of special interests in capturing the policy making apparatus. In many, though not all, cases, these are the same special interests that enjoyed privileged access to public rents during the single-party period. Although the demise of the one-party system may have been expected to weaken the privileged positions of these vested interests and usher in a new era where benefits of the government policies and economic development are more widely shared, such a change has yet to take place. Why? This IGR addresses this crucial question, and in so doing tries to offer some insights into how Mexico’s democratic governance may be strengthened over time.

1.4 This study shows that while the transition to democratic governance is underway in Mexico, a number of interest groups are mediating – and many times capturing – the relationship between the political leadership and the citizens in general (as voters), affecting the provision of public goods and services. Their influence has been due in part to their own specific leverage over the policy making process, particularly the ability to strike or otherwise disrupt key state functions or sources of revenue. Free and competitive elections should be a means by which the general public could become a counter-weight to these special interests. However, a number of obstacles exist to limit the ability of voters to hold politicians accountable for performance, and thus allow them to continue catering to special interests at the expense of general public interests in many cases.

1.5 What complicates the reform agenda in Mexico is that efforts to improve policy quality need to happen in the middle of a political transition with still uncertain outcomes. The process started at least in the 1980s, if not earlier, when major sub-national jurisdictions, starting with Ciudad Juárez at the municipal level and Baja California at the state level, began to see heightened electoral competitions (see Table 1.1). The eventual fall of the PRI from power at the national level is just a mid-point of this evolving process. For more than 70 years, Mexico operated under a particular (and very unique) set of rules of the political game that were fairly clear and predictable, described by a veteran Mexican political scientist as “loyalty and discipline in exchange for benefits” (Rubio 2004). The central piece of this political system, the single-party dominance by the Institutional Revolutionary Party (PRI), has now crumbled and is unlikely to return (Figure 1.1). But, as the controversies surrounding the 2006 presidential and gubernatorial elections attest, Mexico’s electoral democracy is still somewhat frail.



Source: Grindle (2005) and Bank staff calculations.

1.6 In the ongoing process of transition away from the highly centralized single-party regime, uncertainty remains regarding how the political system will evolve over the coming years. Yet, it is the functioning of the political system that will largely determine the quality of government policies. The interactions of the remaining policy deficiencies in the context of a fluid political transition process pose particular challenges of governance, irrespective of who is in power.

Table 1.1 Chronology of Political Opening in Mexico

YEAR	EVENTS
1963	1) First reform to the 1946 Electoral Law (<i>Diputados de Partido</i>). 2) First municipality won by an opposition party: the PAN.
1968	Derogation of Articles 145 and 145bis of the Penal Code ⁴ .
1977	1) <i>Ley Federal de Organizaciones Políticas y Procesos Electorales</i> . 2) Liberation of 424 political leaders incarcerated after the 1968 and 1971 social uprisings.
1979	Consolidation of 3 new political parties in the mid-term elections.
1983	1) Municipal Reform. 2) Between '81 and '83, important municipalities "awarded" to the PAN in Northern Mexico.
1985	Boom in the formal creation of civil society organizations after the earthquake.
1986	New Federal Electoral Code (100 new seats in Congress & Governance Clause).
1987	1) <i>Pacto de Solidaridad Económica</i> to face the 1982 crisis. 2) Creation of the <i>Frente Democrático Nacional</i> , PRI offspring, by Cuauhtemoc Cardenas and Porfirio Muñoz Ledo.
1988	The PRI loses for the first time its two thirds majority in Congress needed to pass Constitutional amendments.
1989	1) Baja California is the first state to be won by an opposition party (PAN). 2) The <i>Frente Democrático Nacional</i> becomes the <i>Partido de la Revolución Democrática</i> (PRD.)
1990	Creation of the <i>Instituto Federal Electoral</i> (IFE) and the <i>Tribunal Federal Electoral</i> (TRIFE.)
1993	Electoral Reform on party finances.
1994	1) <i>20 Compromisos por la Democracia</i> , later <i>Acuerdo Nacional por la paz, la justicia y la democracia</i> (or <i>Negociaciones de Barcelona</i> .), setting the basis for the next big electoral reform. 2) First public debate between the three main presidential candidates. 3) The Grupo San Angel was created by representatives of all the political parties, the private sector, academicians, and citizens to reduce political tensions through a national dialogue.
1995	<i>Acuerdo para la Reforma Política</i> , a dialogue between Zedillo and all political parties on: elections, executive-legislative relations, federalism, and citizen and media participation.
1996	Next big Electoral Reform - IFE's full independence: a. In Congress, no party can have more than 300 <i>Diputados</i> (60%); and now 2 senators for the majority, 1 for the biggest minority, and 32 by Proportional Representation; b. Mexico City would be holding its first elections for Mayor and the Heads of the 16 <i>Delegaciones</i> starting in 1997.
1997	1) Cuauhtemoc Cardenas (PRD) becomes the first elected Mayor of Mexico City. 2) 77% turnout in the mid-term elections, in which the PRI loses absolute majority of the <i>Cámara de Diputados</i> for the first time, but keeps it in the Senate. 3) Porfirio Muñoz Ledo becomes the first opposition Deputy to officially reply, as President of Congress, to the President's State of the Union Address.
1999	PRI is the first party to select its Presidential Candidate through an open and nationwide primary, with a turnout of 10 million voters.
2000	On July 2 nd Vicente Fox becomes the first President from an opposition party (PAN.)
2002	Creation of the <i>Ley Federal de Acceso a la Información</i> and creation of the IFAI.
2003	Mid-term elections are held and Congress is reshaped again. The PRI manages to keep 40% of the seats, the PAN drops from 41 to 30%, and the PRD increases from 10 to 19%.
2006	PAN wins the presidency for a second consecutive term, but the votes are divided among PAN, PRD and PRI; PRD refuses to accept the results. Similar disputes are repeated at the state level (e.g., Chiapas), posing a challenge to Mexico's electoral system. Congress is again reshaped, with the PRI dropping significantly to 21%, the PAN recovering to 42%, and the PRD increasing to 25%.

⁴ These articles forbade the organization of groups of more than 5 people to talk about political issues, especially against the Establishment.

1.7 Scholars have debated how to categorize Mexican politics along the theoretical continuum between democracy and autocracy.⁵ Here our interest is not in labeling Mexico's political system at different historical moments as either democratic or non-democratic, but in capturing its main characteristics to the extent they are expected to influence the quality of its governance. Of particular interest to us is the way in which political power is exercised by different groups in society, and how this is changing (or not) as a result of the ongoing political transition in Mexico. In this report, we focus on two types of such changes: (i) increasing competitiveness of elections; and (ii) dispersion of political powers as a result of the PRI's gradual loss of monopoly control of key state institutions, especially evidenced in the phenomenon of divided government where the ruling party does not control a majority in Congress.

1.8 First and foremost, the ongoing political transition is driven by the increasing competitiveness of the electoral process. All else equal, competitive elections should make politicians more responsive to the demands and the interests of the majority (or at least plurality) of voters, which is the essence of representative democracy. This report asks: has electoral competition had the expected impact on political responsiveness and electoral accountability, and if not, why not? Evidence gathered for this report, though not conclusive, suggests that with regard to the first part of this question, the answer is mixed. Politicians are increasingly responding to voter demands, but the effectiveness of these responses is dampened by other countervailing forces, including the persistently strong influence of specific interest groups that have long enjoyed privileged positions in the Mexican political system and ambivalence of Mexican voters regarding desired policy directions.

1.9 Second, Mexico was long characterized by the extreme centralization of political powers in the hands of the national executive. But since the mid 1990s, institutional checks and balances on the executive's political discretion have become a reality. The 1994 constitutional reform provided the Supreme Court with greater political independence, and since 1997, the president's party has not held majority control of the Congress. Checks and balances exercised by countervailing powers of multiple institutional actors could improve democratic governance by limiting abuse of power by any one of them, especially the president.

1.10 In addition, during the last decade, Mexico also experienced a decentralization process and began devolving responsibility to states for key services like education and

⁵ On the one hand, reasonably free elections characterized the PRI's single party dominance. On the other hand, there were frequent allegations of electoral fraud, vote buying, and even selective repression that appeared more characteristic of an autocratic regime. But until the 1980s, it was unlikely that any opposition party would have been in a position to defeat the PRI at ballot booths in any case. Some scholars define as a democratic regime political systems that have had at least one peaceful and constitutional change of government, which Mexico (at the federal level) did not experience until 2000. See, for example, Magaloni (2006) for a review of these definitional/conceptual debates within the academia.

health. For example, federal transfers to states in education increased dramatically, from \$214 (pesos) per capita in 1992, to \$1,814 (pesos) per capita in 2004.⁶

1.11 Although decentralization in Mexico is far from being complete,⁷ it has already led to fragmentation of the power of the central government in the definition and delivery of public policies. As a recent World Bank report on the topic *Decentralized Service Delivery for the Poor* states, “(t)he expenditure powers of the Federal Government have been reduced to the benefit of sub-national governments. Additionally, many more authorities now participate actively in budgeting, spending and auditing of federal resources” (World Bank 2006b: 148).

1.12 Both the establishment of increasing checks and balances mechanisms and the decentralization process underway are by themselves a welcome development, especially given Mexico’s recent political history. By the early 1990s, when the PRI-controlled executive still enjoyed quite a high level of discretionary authorities, some observers were already calling for effective checks and balances as a central element of much-needed reforms of the political systems.⁸

1.13 On the other hand, the increase in the number of institutional players with the ability to restrain the executive may result in slow-down of the policymaking process, or so-called gridlock. In fact, the perception of gridlock was a repeated theme in political commentaries in Mexico during the Fox *sexénio*. This report revisits the issue of gridlock and concludes that fears of gridlock – defined narrowly and specifically as the government’s inability to pass constitutional or legal reforms *because of partisan differences in the legislature* – have likely been overstated. Our evidence leads us to conclude that gridlock, to the extent it exists, is confined to constitutional changes.⁹ Although the difficulty in passing some of the pending reforms is undeniable, it is not clear that the primary causes of this difficulty are institutional (i.e., due to the particular constitutional structure of the Mexican state) and thus amenable to correction by institutional re-engineering. Rather the observed difficulties in the reform agenda seem to have their roots in societal factors, especially the roles of certain groups in undermining reform initiatives that threaten their vested interests and the polarization of society that prevents formation of a genuine national consensus in many policy areas.

⁶ Based on SHCP and World Bank staff calculations.

⁷ As reflected in World Bank (2006b), decentralization in Mexico faces a number of challenges including the lack of clear and stable definitions regarding the responsibilities of each level of government in the provision of services.

⁸ See, for example, CIDAC (1990).

⁹ While some of the pending reforms require constitutional changes, others do not.

POLITICAL TRANSITION IN MEXICO

From Single-Party Hegemony...

1.14 During the long-endured PRI regime, Mexico was known for a high degree of centralization in political decision-making, where the presidential authority reigned supreme. The executive completely dominated the legislature thanks to the extraordinary discipline of the PRI, of which the President was the head. The strength of the presidential dominance was reflected in the astounding 99.8% success rate in getting the executive's legislative proposals approved by congress even in its latter days of 1994-97 Congressional period (Nacif 2002).¹⁰

1.15 It is well established in the academic literature that the strength of Mexican presidents during the PRI period in fact resulted not so much from their formal constitutional powers but from so-called meta-constitutional powers thanks to the simultaneous role of the president as the head of the hegemonic party with a vast array of informal powers at its disposal (Weldon 1997). As head of the PRI, the presidents could count on impressive party discipline that guaranteed block voting by the PRI legislators, who controlled the qualified majority of 2/3 or more in the Lower House (necessary to secure a vote for a constitutional reform) until 1991.¹¹ The presidents commanded politicians' loyalty because of their ability to dole out all (i.e., national and sub-national) government positions, elected and appointed, to their allies and supporters, or deny them to detractors. In the peculiar system where elected representatives are not allowed to run for immediate reelection (or no reelection whatsoever in the case of executive posts), most politicians looked to the president for their next career opportunities within the political system. In such a system, challenging the political authority of the president (and the PRI head) was tantamount to political suicide.

1.16 The core support base of the regime included the "corporatist" segments of society, such as organized peasants and labor as well as certain business sectors. These groups represented relative minorities in each sector, but served as gatekeepers of access to state largesse and thus obtained disproportionate shares of public rents thanks to their close ties to the PRI. In contrast, general voters had limited influence over the PRI.¹² According to census data for 1960, 70 percent of urban residents belonged to an officially sanctioned union or association, but only five percent of rural residents,

¹⁰ In the same period, PAN and PRD introduced even more bills (124 altogether) than the Executive and the PRI combined (103), yet managed to get only 11 of them approved; less than 10% "success rate."

¹¹ A historical analysis reveals that when the presidents did not control a legislative majority, which was frequent in the 1910s and 1920s, they enjoyed little legislative success (Weldon 2002).

¹² While the PRI drew (and still draws) electoral support from rural voters, these were poorly organized and posed little threat to regime stability and sustenance. As a result, the PRI policies displayed clear urban bias (e.g., in 1988, 70 percent of food subsidies were directed to the Mexico City) because of the presence of the majority of the corporatist support base in urban areas (Lehoucq et al. 2005, p. 14).

despite the fact that rural residents were a majority of the population.¹³ This privilege was institutionalized: an average of 43 percent of PRI representatives in the Congress over the period 1964-2002 came from corporatist groups (Lehoucq 2006, p. 15).¹⁴

1.17 Given this support base, the regime's main strategy for political survival was reliance on revolutionary rhetoric and relative success in economic management (although beginning in the 1970s macroeconomic management became increasingly unstable). The PRI complemented this strategy with skillful capturing/incorporation of organized groups into the rent-sharing arrangement within an institutionalized network of personalist and corporatist alliances. The regime's economic base was somehow sustained with selective protection of property rights, as the state was not developed enough to provide generalized protection of property rights when the post-revolutionary economy badly needed investments (Haber, Mauro and Razo 2003). This arrangement survived throughout the years in the form of government protection for and rent sharing with certain domestic industries, with negative effects on overall economic efficiency. Finally, it is well-known that the PRI frequently resorted to electoral manipulations on a selective basis as an additional (and ultimate) means to secure its hold on power (Magaloni n.d.).

1.18 The arrangement "worked," as it lasted for 71 years. Although the regime was far from fully democratic, its use of elections as mechanisms for determining leadership succession (and partly for sharing of spoils) legitimized it in the eyes of many Mexicans and foreign observers. Most importantly, the system rested on a fine equilibrium whereby all the beneficiaries of the system – though relatively few in number in comparison to the population at large – had a vested interest in the continuation and maintenance of the specific rules of rent sharing, while the vast majority of Mexicans were given no viable political alternative to the PRI. The regime's adroit use of a variety of means to reward the supporters and punish the detractors – especially the discretionary use of budgetary resources made possible by the total control of the state apparatus by the highly disciplined single party – quieted would-be opposition (Diaz-Cayeros, Magaloni and Weingast 2003).

1.19 Apart from its many shortcomings, the PRI regime was successful in defining a long-term national project of power building and concentration, for which social cohesion and a degree of distribution were necessary. The PRI also achieved, and largely maintained, social peace and kept Mexico from slipping into military dictatorship unlike most of its Latin American neighbors. The party constituted the main recruitment agent for the public service, and through an informal system of incentives centered around networks of personalistic circles (*camarillas*), it was successful

¹³ In 1960, approximately 45 percent of Mexicans were in rural, 38 percent in urban and the remainder in mixed areas (Hernández Esquivel 2003).

¹⁴ In the newly established 2006 legislature, over 90% of PRI representatives in the lower chamber come from trade unions. This may be the result of the PRI losing almost half of their seats and the important influence that trade unions have in ensuring their candidates to be on top of the list of proportional representation.

in establishing a relatively common vision for those working for the different levels of government (Bastidas 2005).

1.20 The long reign of single party hegemony allowed the PRI to embark on relatively stable policy directions in some (but not all) periods. The practice whereby the departing president was given the exclusive right to anoint his successor enabled him to choose someone who was likely to continue with his preferred policy directions. This practice, combined with the PRI's ability to downplay potential electoral repercussions for unpopular policies, allowed the succession of three reformist presidencies to implement market-oriented economic reforms over the 1980s-90s (Centeno 1997).

1.21 The resulting political arrangement was one where the small number of privileged groups such as those domestic businesses that benefit from state protection and subsidies and corporatist labor groups operating with monopoly control over labor segments extracted state rents in exchange for support and loyalty for the system. General voters acquiesced because of the lack of viable alternative to the PRI, even though these interests extracted benefits from the political system out of all proportion to their number. In exchange, the PRI maintained relative social peace, political stability (though ripe with corruption), relatively good, though not stellar, economic performance, and low taxation.

Table 1.2 Main Social Bargains between State and Society under the PRI

<i>Area of credible commitment by state</i>	<i>Societal group's part of bargain</i>
<p><u>Government/political elite</u></p> <p>Support for rent creation</p> <p>Selective protection of property rights/rent appropriation</p> <p>Fora for bargaining</p>	<p><u>Business elites</u></p> <p>Investment in wealth and rent creation</p> <p>Avoiding capital flight</p> <p>Bargaining within agreed fora</p>
<p><u>Government/political elite</u></p> <p>Rent-sharing</p> <p>Social provisioning</p> <p>Fora for bargaining (via corporatist structures)</p>	<p><u>Workers and peasants</u></p> <p>Political support, including in formal voting</p> <p>No revolt</p> <p>Bargaining within formal fora</p>
<p><u>Government/political elite</u></p> <p>Relatively good macroeconomic performance (1950s-60s)</p> <p>Relative social peace</p> <p>Low taxation</p> <p>Gradual expansion of social services</p>	<p><u>General citizens</u></p> <p>Acceptance of the single-party regime with limited electoral accountability</p> <p>Migration</p>

Source: Adopted from Guerrero, López-Calva and Walton (2006).

... To Competitive Elections and Checks and Balances

1.22 The gradual transition process that culminated in the victory of an opposition presidential candidate in 2000, for the first time since the establishment of the Revolutionary National Party (PNR, PRI's precursor) in 1929, has steadily undone some of the building blocks of the centralist presidential regime. Most notably, Mexican voters now have real alternatives to the PRI, and can exercise these choices meaningfully both at the federal level and at the sub-national levels, although the degree of electoral competitiveness varies from one locality to another at the state and municipal levels. As states and municipalities have acquired much greater policy responsibilities since the early 1990s, some have argued that decentralization of the political, administrative and fiscal structures is changing not only the distribution of power and resources across territorial entities, but also politicians' incentives and their strategies for career survival/advancement (De Remes 2005). Decentralization combined with more vibrant

political competition may be complicating the task of inter-governmental coordination, on the one hand, but creating new opportunities for governance improvement in specific sub-national jurisdictions, on the other.¹⁵

1.23 In some states where the PRI lost control of the Executive but still maintained a significant force in the legislature, divided governments emerged and limited the executive's discretion. Referring to the case of Chihuahua in the mid 1990s, De Remes (2005, p.19) described the situation:

The state legislature became an important "check" on the state executive especially on issues concerning the budget allocation, state social communication items, and distribution of funds to municipal governments to increase welfare policy at the local level. However, the most contentious issue for state government came in December 1996, when the legislature decided to amend 0.7% of the annual budget by reducing items concerning public works, social spending, and administrative expenses at the state level. [C]uts were reallocated to the municipalities and to the legislative power, two spheres in which the PRI had a definitive advantage over the PAN. The changes were approved by legislators of the PRD and the PRI [...] The Governor decided to veto the altered budget in December 30 [...] For 67 days, the struggle between the executive and legislative powers went on.

1.24 Electoral victories of opposition parties (PAN and PRD) have not meant the PRI has permanently exited from electoral competition (Figure 1.1), however. In the states of Chihuahua, Nayarit, and Nuevo Leon, the PRI returned to the governorship after losing to the PAN. In 13 out of the 32 states, the PRI has yet to lose a gubernatorial election. Thus, in Tamaulipas, one of the states where the PRI has yet to lose, the PRI dominance in state politics continues, as reflected in the impressive record of the legislative "success" by successive governors. Both in terms of the proportion of the bills sent to the legislature and approved and the share of the governor's proposals in the total bills passed as laws, the government of Tamaulipas has proven highly efficient. But even here the bills proposed by the governor as a share of the total declined in the 1990s (Table 1.3).

¹⁵ For example, evidence on the impact of competitive elections at the sub-national level shows that elected governments become more responsive to citizen demands (Boyce 2005, Hiskey 2003, and Moreno 2005).

Table 1.3 Governors' Legislative Successes: Tamaulipas, 1981-2001

	1981-83	1984-86	1987-89	1990-92	1993-95	1996-98	1999-01
Sent	66	70	37	42	38	23	68
Approved	66	70	37	37	38	23	62
"Success" rate	100%	100%	100%	88%	100%	100%	91%
Governor's proposals	90%	77%	77%	55%	58%	56%	84%
Legislators' proposals	10%	15%	10%	7%	37%	41%	9%
Proposed by Municipalities	0%	8%	13%	37%	5%	2%	7%
(N)	(73)	(91)	(48)	(67)	(65)	(41)	(74)

Source: Ramírez Gutierrez (2003), cited in Magar and Romero (2006).

1.25 The decay of the PRI hegemony happened gradually. As long as the PRI faced limited nationwide opposition, the President had significant leverage over the policy making process: in the face of opposition by corporatist interests or PRI dissidents, he could credibly cut them off from the benefits of PRI control of the government, because they had no political alternatives to which they could turn.

1.26 The breakdown of the PRI's hold on power began in the 1980s, when the debt crisis shook the country's economy, and the government's response with the adoption of market-oriented reforms alienated some of the traditional supporters of the PRI. The same economic crisis diminished the state's capacity to reward supporters with fiscal resources. Economic opening pursued since the 1980s increased the incentives of those localities that became more integrated with the international economy to defect from the inefficient PRI-controlled system (Diaz-Cayeros, Magaloni and Weingast 2003).

1.27 As the period of PRI hegemony faded, dissidents became bolder, forming new parties (the PRD) or increasing internal resistance (the *dinosaurios* against market-oriented reforms pushed by the last 3 PRI presidents). The president (first Salinas and especially Zedillo) shifted strategies by offering opposition parties (PAN) reforms that leveled the political playing field (further reducing PRI hegemony) in exchange for their support of economic reforms. By the time of the *alternancia*, opposition parties had a more national presence than before, so defection was a more credible option for party dissidents displeased with the president, while the presidents had less to offer as rewards to loyal insiders, at the expense of the general population. The informal, as well as formal, rules of the game had changed.

1.28 The fine equilibrium of "loyalty and discipline in exchange for benefits" has broken, as the PRI is no longer able to offer long-term political rewards to its supporters, both the committed and the opportunistic. The result seems to be fluid strategic posturing by parties (e.g., basing their decisions to support a particular legislative proposal on whether it would further their immediate electoral benefits, including by "spoiling" the government's reform proposal just to make it look inept) and politicians

(e.g., party switching and vote buying in congress) that reduces the predictability of political transactions.

1.29 In addition to breaking the political monopoly of the PRI in Mexico, the transition to democratic governance brought other benefits to society in terms of increased levels of access to information and avenues for citizen participation in government affairs. The Federal Information Access Law (*Ley Federal de Acceso a Información*) constitutes a key legal instrument to open the government to citizen scrutiny for improved accountability. The law was first formulated by civil society actors and approved with unanimity in Congress.¹⁶ This law opened new and important spaces for citizen oversight and participation.

1.30 The information access law, in some ways, was a product of the mounting pressure from civil society to demand greater access to public decision-making. By the mid 2000s, a number of participatory mechanisms have flourished at the federal, state, and municipal levels.¹⁷ Although there is a need for strengthening these mechanisms beyond the current situation and making sure that they do not become ritualized, civil society has made important progress in increasing its level of participation in policy formulation and oversight of public programs.

1.31 In order to guarantee the full implementation of the information access law and respond to the unexpectedly large demand, the government created the Federal Institute for Access to Information (*Instituto Federal de Acceso a la Información* – IFAI) as a decentralized agency with operational, budgetary and decision-making autonomy.¹⁸ Since the beginning of its operations in June 2003, over 120,000 requests for information have been submitted to federal agencies and almost 6,000 of them have been referred to IFAI for appeal. Information gathered through the Access to Information Law and

¹⁶ The law was passed in Congress on June 12, 2002.

¹⁷ Isunza (2005) identifies 347 mechanisms for “state-society relations” that he categorizes in 6 types of “interfaces”: (i) contribution; (ii) transparency; (iii) communications; (iv) mandate; (v) transference; and (vi) co-management.

¹⁸ IFAI’s main responsibilities include: (i) overseeing implementation of the Law and promoting access to information policies in the country; (ii) issuing regulations regarding terms and procedures for providing public information to citizens, as well as management of data and archives in federal agencies; (iii) guaranteeing the right of access to government information; (iv) protecting personal data and information administrated by federal agencies; and (v) analyzing and resolving denials of information requests issued by federal agencies. IFAI also has the authority to access any information without restriction from any federal agency or dependency, including confidential information. Since its creation, IFAI has focused on two areas deemed necessary to make the law effective and enforceable: (a) archives management, through the development and implementation of a normative and technical framework for the appropriate use and administration of information archives by federal agencies; and (b) developing and implementing an effective information system to track citizens’ requests for information from federal agencies, ensuring prompt and adequate responses.

enforced by IFAI led to discovery of wrongdoing by government agencies such as cases of corruption and violations of the environmental regulation.¹⁹

1.32 Following the path opened by the federal information access law and the establishment of the IFAI, 28 out of the 32 federal entities have passed their own version of the freedom of information act and have put together state-level access to information institutes. In addition, Mexicans today discuss the “constitutionalization” of access to information as a fundamental citizen right.

1.33 Another important reform during the Fox *sexenio* is the passage of the Professional Civil Service Law, aimed at building a merit-based cadre of middle-level managers in the central administration. This new legislation is intended to provide formal regulations to professionalize a critical segment of the public administration at the Federal Level. Some 63,000 senior staff and mid-level managers (a little more than 10% of the total) will be subject to a transparent accreditation process that would incorporate modern merit and performance-based evaluation systems to enhance overall capacity and efficiency within federal agencies. Given the historically symbiotic relations between the ruling party (PRI) and the bureaucracy, establishing an independent, professional civil service constitutes an important facet of the ongoing transition. The scope of the legislation is restricted, however, to a critical but rather small group of public servants. Other personnel from key sectors like teachers or health workers as well as the large portion of low-level staff (*trabajadores de base sindicalizados*) are still subject to pre-existing regulations and the rather protective labor legislation.²⁰

1.34 The introduction of political checks and balances and competitive elections is only the first democratic transition of Mexico. The remaining chapters of this report discuss obstacles to be overcome as Mexico makes its second transition. For example, despite competitive elections, it has been pointed out that remnants of the recent authoritarian past continue to exert considerable influence within the political system, both at the national and sub-national levels. Some of these, loosely called “authoritarian enclaves,” are plausible causes of some of the failed attempts to pass structural reforms

¹⁹ For example, through the use of the Access to Information Law, Mr. Arturo Fernandez Lopez found out misuse of funds of the National Fund for Disasters. His case reached Congress, resulting in the destitution of the head of the agency. Mrs. Cristina Martin and Mrs. Vera Sisniega obtained information proving that the proposed construction of a segment of the Mexico-Acapulco highway violated environmental codes. This resulted in the modification of the design of the proposed work in accordance with the relevant law.

²⁰ There have also been concerted efforts to reduce regulatory burdens on the private sector through agreed agenda of reform actions with Congress and the private sector. In the context of the creation of the Competitiveness Committee, composed of members of Congress and private sector leaders and led by the Office of the President, a number of administrative procedures were identified as critical for smooth functioning of a more dynamic private sector. Based on this list of demands and suggestions, the *Secretaría de la Función Pública* – as a part of its Good Governance Program – initiated a process to reduce these regulatory burdens. This dialogue turned out to be highly effective, resulting in the simplification of a number of administrative procedures. It also shows that there are real opportunities in Mexico to reach consensus among actors in a transparent way, when rules of the game are clearly established.

and to modernize the state. These achieved great influence under the PRI, but even after the PRI's departure from power, some of these actors allegedly continue to operate in "traditional" ways, undermining effects of democratization (Box 1.1).²¹ Some observers argue that the government apparatus in the public security sector is particularly prone to this problem. The sector had been used in the past not primarily as an instrument for public service provision but for political control and repression of society. This has created strong forces of collusion and vested interests in the status quo that may block efforts to modernize and professionalize the security bureaucracy (López Portillo 2000). More generally, the evidence that the democratic transition is incomplete comes from the policy record. As the next chapter demonstrates, Mexico has been slow to adopt policy reforms to reverse a legacy of legislation favoring special interests at the expense of society more broadly.

Box 1.1 Mexico's Unfinished Transition and Authoritarian Enclaves

The victory of Vicente Fox in Mexico's July 2000 presidential elections represented the culmination of a long process of political opening in Mexico. But as Lawson (2000) argues, democratization has not proceeded at the same pace across all regions or spheres of government, and as a result, Mexico's new political order comprises a series of authoritarian enclaves in which the old rules of the game still operate.

One of these enclaves is the *electoral regime*. For the most part, the array of old-fashioned tactics designed to protect the PRI's hold on power were eliminated by a series of revisions to the electoral code, especially those in 1996.²² However, some of these practices are still used in traditional PRI strongholds. Mexico's IFE only has jurisdiction over national contests, and sub-national elections are monitored by state-level organizations that vary dramatically in political independence and technical capacity. In states where opposition parties have already won the governorship, voter registries have been appropriately purged, electoral oversight is strict, and irregularities are relatively rare. But in traditional PRI strongholds, the old tactics are still present. In addition, there are problems with Mexico's electoral system from the standpoint of political accountability such as the use of closed party lists to assign proportional representation seats (although this is not necessarily uncommon in other democracies), the restrictions on voting for Mexicans living abroad and the rules regarding campaign finance and the provision of campaign resources.²³

Other examples mentioned by Lawson (just prior to 2000) include the following.

²¹ Writing on the eve of the PRI's historic defeat in the 2000 election, Lawson (2000) identified the federal bureaucracy, the judiciary, portions of the mass media, and certain localities where PRI control continued, as examples of these authoritarian enclaves. For example, the author stated that police forces were highly corrupt, a large number of judges were under-qualified or corrupt, and television remained dominated by two networks, closely associated with the political power.

²² Such as having voter rolls to eliminate opposition voters, padding the registry with PRI supporters, allowing PRI adherents to vote multiple times, heavy-handed clientelism and outright ballot box stuffing and intimidation. These tactics were supplemented by mechanisms used in democracies to protect incumbents such as gerrymandering and unequal provision of campaign resources (including media time).

²³ Mexico's largely public system of financing political campaigns imposes relatively vague limits on private contributions, and reporting requirements for campaign expenditures are lax. Campaign finance problems are exacerbated in Mexico by severe socio-economic inequalities, by the economic influence of a few large corporations linked to the old and/or new political elite, and by the flow of large amounts of drug money in search of political influence.

a) *The party system*: The most important flaw in Mexico's party system is the nature of selection mechanisms for party leaders and candidates. Although the three major parties (PAN, PRD and PRI) made important progress in developing democratic internal selection processes, none has yet completed this task.

b) *Division of powers*: Although much progress has been made to remove the legal prerogatives of the president and his old meta-constitutional powers, the executive still has much more resources compared to the legislative power. Unlike their counterparts in other countries, Mexican legislators have almost no support staff that can provide technical assistance to execute their oversight role.

c) *The federal bureaucracy* remains dominated by adherents of the ruling party (PRI) and as a result, radical policy shifts may be retarded or obstructed by the public officials themselves.

d) *The judiciary*. Under the old regime, Mexico's judicial branch was thoroughly subordinated to the executive authority. Reforms launched by Zedillo in 1994 have strengthened the autonomy of the judiciary. However, the Supreme Court is still formed by members appointed by presidents from the PRI and the Court has not yet found consistent, neutral criteria for ensuring the rule of law. Court decisions are at best erratic and despite the 1994 reforms, many judges remain under-qualified or corrupt.

e) *The mass media*. For decades, Mexico's media were co-opted and constrained by the country's authoritarian regime. Despite the erosion of official control over the last two decades and the advances made by print media and radio, by the year 2000 the country's most influential medium, the television, remained dominated by two commercially oriented private networks with links to the PRI – Televisa and Televisión Azteca.

SUMMARY

1.35 Mexico has made good progress toward building a democratic governance framework. As Mexico has shifted from a single-party regime to a competitive elections system, citizens are taking increasingly active roles in deciding the future of their society. Many practices of the old PRI regime are being slowly dismantled. The long-term dominance of a hegemonic party – characterized by high levels of political power concentration and meta-constitutional powers invested in the President – slowly gave space to the emergence of democratic institutions based on division and decentralization of powers and increased checks and balances. Political competition at all levels of government resulted in party turnover and greater access to government information, although the pace of the progress varies between the federal and the sub-national levels and among the sub-national jurisdictions.

1.36 The introduction of political checks and balances and competitive elections is only the first phase of the democratic transition process in Mexico. The remaining chapters of this report discuss obstacles to be overcome as Mexico makes its second transition to deepen its incipient democracy. These chapters review how the two main characteristics of the ongoing political transition in Mexico – namely the increased electoral competition and the advent of divided government – and their effects on government policy performance. The final chapter offers a perspective on how to tackle remaining constraints to democratic consolidation.

2. THE POLITICAL OPENING AND PRESSURE FOR PRO-POOR POLICIES

2.1 Evidence so far shows that greater electoral competitiveness has begun to make politicians (and governments) more responsive to general voter demands. But this pressure is still dampened by countervailing forces. A minority of voters press for such changes, but efforts to deepen social policies (e.g., by making teachers more performance oriented) and to expand the state's fiscal capacities so that social services can be expanded without affecting other spending priorities face stiff resistance from special interests that have long enjoyed privileges.

2.2 In Mexico, competitive elections and democratic change of government at the sub-national level preceded the historic moments of political opening at the federal level. Thus, developments at the sub-national levels (where electoral competitiveness spread earlier) might provide pointers for where governance is headed at the national level.

2.3 Analyzing the performance of the National Solidarity Program (*Pronasol*) under the Salinas administration, Hiskey (2003) found that program performance in improving basic service coverage tended to be better in those municipalities where local elections were competitive and perceived to be fair (i.e., there was a distinct likelihood that the PRI could lose elections). Boyce (2005), on the other hand, reports that Mexican states with higher levels of political competition tended to register worse credit ratings and higher own tax collection, apparently because political competition increased pressure for government spending. Moreno (2005) demonstrates that the narrower the margin of victory in municipal elections (i.e., the more competitive municipal elections are), the greater local infrastructure spending is: a one percentage point decrease in the margin of victory is associated with an increase in local infrastructure spending of 72 pesos/capita. These increases in infrastructure spending, however, could be indications of increased basic services, such as potable water or rural access roads, or signs of pork-barrel public works with limited welfare effects.

2.4 The evidence gathered from the literature is consistent in indicating that competitive elections at the sub-national level are changing government behavior, but not always in ways that improve the quality of governance. Does the same pattern hold at the national level? If so, what gets in the way of improved governance under Mexico's increasingly competitive electoral environment? What prevents citizen voice from being more fully reflected in governments' policy outputs?

INCREASED ELECTORAL COMPETITION AND PRESSURE FOR “PRO-POOR” POLICIES

Political Opening and Policy Quality

2.5 In the late 1990s, Mexico allocated 52 percent of total public spending to social sectors. Low overall government spending translated this into a meager 8.65 percent of GNP. As Table 2.1 illustrates, during that period, Mexico stood out in Latin America for its low level of total spending. Correspondingly, its level of social spending contrasted starkly with the spending levels in other larger countries in the region such as Argentina and Brazil, which spent more than 20 percent of their GNP in social sectors.²⁴

Table 2.1 Government and Social Spending in Latin America

Total Expenditures as share of GNP	Share of total spending going to social sectors		
	Less than 40 percent	Between 40 and 60 percent	More than 60 percent
More than 30 percent	Nicaragua (12.7) Colombia (15.0) Panama (19.4)	Costa Rica (16.8)	Argentina (20.5) Brazil (21.0) Uruguay (22.8)
Between 20 and 30 percent	Honduras (7.4) Venezuela (8.6)	Bolivia (16.1)	Chile (16.0)
Less than 20 percent	El Salvador (4.3) Dominican Republic (6.6) Peru (6.8)	Guatemala (6.2) Mexico (9.1) Paraguay (7.4)	

Note: The numbers in parentheses correspond to the percentage share of social spending in a country's Gross National Product (GNP).

Source: United Nations Economic Commission for Latin America and the Caribbean (2001).

2.6 As we would expect, with competitive elections better enabling the poor majority to hold government accountable for performance, this picture changed from 2000-2005. Spending on social sectors (education, health, social security, labor, social assistance, and urban and regional development) rose 4.3 percent annually, faster than the growth of both GDP and total public spending, and in 2005 social spending reached 10.1 percent of GDP.

2.7 In addition, public expenditure on health services has become more progressive, with the share going to rural residents rising from 20 to 28 percent of the total, and the share going to the Mexicans in the lowest income quintile rising from 8 to 15 percent, compared to the early 1990s (World Bank 2004). Similarly, progressivity in the education sector improved with the expansion of enrollment and the increase in public expenditure in basic education. Most notably, the share of the poorest quintile enrolled in the lower secondary education increased from 8 percent in the early 1990s to 20 percent currently, thus completely eliminating the earlier gap in coverage. The

²⁴ However, this does not necessarily mean that these social expenditures are efficiently and equitably allocated to address needs of the poor.

generalized (and thus regressive) food subsidies were replaced with targeted anti-poverty program *Progres-a-Oportunidades*, which, in turn, was significantly expanded since 2000, doubling the number of beneficiaries between 2000 and 2002 (World Bank 2004). While targeting of resources has dramatically improved, overall spending has improved by much less. In 2003, government spending on health care in Mexico was 1.2 percentage points below the predicted value for 99 other countries with competitive elected governments in that year (more than one half of a standard deviation).²⁵

2.8 On the other hand, a recent report on the politics of policymaking in Latin America by the Inter-American Development Bank (2006) reflects a more mixed picture. The report applies a composite measure of policy quality across selected Latin American countries.²⁶ The measures for Mexico compare the period prior to 1997 – the year when the PRI lost the majority control of Congress – and since then.²⁷ According to these measures, policy quality in Mexico has improved on two dimensions in a way that is expected from a more democratic political system, namely “public-regardedness” and “efficiency.” Both measures relate to the extent to which policies benefit the general welfare of the society as a whole as opposed to catering to the interests of the privileged few. Based on available survey data (e.g., the Global Competitiveness Report of the World Economic Forum) as well as the specially designed State Capabilities survey conducted for their study, the IDB measure of “public-regardedness” captures:

1. The extent to which public officials tend to favor the well connected in their policy decisions.
2. The extent to which social transfers effectively reach the poor as opposed to the rich.
3. The ability of the State to impose losses on powerful actors.
4. The extent to which the government represents diffuse, unorganized interests, in addition to concentrated organized interests.

The “efficiency” measure, in turn, measures efficiency in allocation of public resources, and is based on:

1. Whether the composition of public spending is wasteful.
2. Whether the resources are targeted where most effective.

²⁵ If one controls for income per capita, on the (not necessarily correct) assumption that poorer countries can afford to spend a smaller fraction of GDP on health care, Mexico is still .8 percentage points of GDP below other democratic countries.

²⁶ These measures were developed specifically for this IDB report, on the basis of the State Capabilities Survey, a survey of more than 150 experts in 18 Latin American countries. The IDB (2006) notes that “respondents to the State Capabilities Survey were explicitly asked to base their answers not on the performance of public policies under the current administration, but rather on performance in the last couple of decades, or since the country’s return to democratic rule” (p. 131).

²⁷ The survey was carried out in 2005.

2.9 As shown in Table 2.2, in the first period (roughly until 1997), Mexico’s score in “public-regardedness” (1.57 in a 1-4 scale) was among the lowest in the region, and well below the regional average of 1.99. This has improved to 2.21 in the second period, placing Mexico above the regional average. The “efficiency” score fared slightly better – the apparently low score of 1.89 actually placed Mexico slightly above the regional average of 1.85 and in the mid range of the individual country scores that ranged from the low of 1.21 to the high of 2.92. Here, too, there is a sign of slight improvement in the second period, which more or less coincides with the current period of greater political opening.²⁸

Table 2.2 Measures of Policy Quality

	Adaptability Index	Stability Index	Enforcement and Implementation Index	Coordination and Coherence Index	Public Regardedness Index	Efficiency Index	Overall Policy Index
MEX1	2.71	3.07	2.33	2.83	1.57	1.89	2.40
MEX2	2.47	2.79	2.16	2.19	2.21	2.20	2.34
LAC Avg.	2.37	2.54	2.08	2.12	1.99	1.85	2.16

Source: Inter-American Development Bank (2006).

2.10 The decline in the scores on dimensions such as “adaptability” and “coordination and coherence” suggests a tendency that is consistent with the common perception of gridlock and the greater dispersion of decision-making powers in the political system (see below for more discussion on this question). But, the relative improvements in “public-regardedness” and “efficiency” are encouraging precisely because these are the kinds of changes one would expect as positive effects of the political opening that gives meaningful voice to the majority of voters. Thus, to the extent these composite measures accurately capture the general tendency of policy quality in Mexico, there are reasons for optimism.²⁹

2.11 Table 2.3 offers further evidence that in some respects Mexico has made admirable strides, but in others continues to fall far short. The regressions reported in the table compare Mexico to all other democracies, taking into account possible constraints on political decision making, such as income per capita, the share of the population that is rural or young, and the sheer size (land area) of the country (not reported). They reveal first, as reported above, that Mexican public health expenditures in 2003 were almost one percent of GDP below the average of other democracies, taking into account country characteristics. In 2000 (the last year for data across a large enough sample of countries), total tax revenues were also substantially below the average in comparable countries, by 6.7 percentage points of GDP (a number that is unlikely to

²⁸ Not all countries had their policy quality assessed in two different periods, as was done for Mexico. Thus, the regional average scores reported in the table are not separated between time periods.

²⁹ The subjective nature of the measures, like many governance indexes that are increasingly common, present inherent limitations, and thus should be interpreted with caution.

have changed in the intervening years, given the difficulties in passing tax reform legislation). Corruption in 2004 was also substantially worse than in other democracies, .57 on a scale of one to six, or one-half of a standard deviation. Corruption undermines the provision of public services and affects the poor disproportionately as typically, low income households and small firms pay more proportion of their income on bribes.

2.12 Yet, Mexico does well if one considers certain outcome indicators. For example, in Mexico there were fourteen fewer infant deaths per 1000 births compared to other democracies in 2004, almost half of a standard deviation better than average. This was true in 1995 and 2000 as well, however, and thus cannot be attributed to the political opening. The paradox that particular social sector outcomes appear to be above average despite under-funding and apparently significant corruption has three possible explanations. First, public expenditure has become more progressive in the last fifteen years, even if spending levels have not grown to match those of other democracies. Second, private sector provision of health and education may be more developed and of higher quality than in other countries. Third, however, easily measurable outcomes may be improving at the expense of outcomes that are difficult to measure.

Table 2.3 Mexican Policy Performance Compared to Other Countries with Competitive Elections

	Public health expenditures/ GDP (%) 2003	Tax revenues/ GDP (%) 2000	Corruption (1-worst – 6- best) 2004	Infant Mortality (deaths per 1000) 2004
Mexico (0-1)	-.84 (3.32)	-6.7 (3.10)	-.58 (4.43)	-12.55 (3.62)
<i>N</i>	98	54	87	95
<i>R</i> ²	.62	.13	.58	.68

NB: A positive Mexico coefficient indicates the amount by which the actual Mexico outcome exceeds comparator countries; a negative, by how much it falls short of comparator countries. *t*-statistics in parentheses. Coefficients for control variables (land area, income per capita, ppp-adjusted, constant 2000 dollars; percent population under 14 and percent population in rural areas) and constants not reported. White-corrected robust standard errors.

2.13 The education sector provides evidence of this third explanation. If one takes into account income, geographic area and demographic characteristics of countries, spending on education in Mexico is actually .6 percent of GDP greater than in other democracies and gross secondary school enrollment is almost exactly what one would predict. Quantity-based indicators of performance therefore appear to be reasonable. These access figures are misleading, however. Mexico is one of 39 countries that participated in the 2003 PISA (Program for International Student Assessment) exams. Using these countries as a basis for comparison, we can compare Mexican performance on both quantity and harder-to-measure quality, based on the PISA scores.

2.14 The PISA countries are mostly richer than Mexico. However, controlling for income, land area and demographic characteristics, and comparing Mexico to the other PISA democracies, we find that Mexican spending on education is about one percent of GDP *greater* than in other PISA countries and secondary school enrollment is 14.9 percentage points *less*. Neither difference is statistically significant. Nevertheless, this contrast already signals a difficulty in turning resources into access to education, since both differences amount to about .75 standard deviations of spending and enrollment across all the PISA democracies. A comparison of PISA scores reveals more significant problems in turning resources into education quality. Mexico's PISA score is 53.2 points less than expected, a statistically significant difference that is equal to 1.36 standard deviations of PISA scores of all the PISA democracies. These comparisons suggest that the quality of education in Mexico is significantly worse than the quantity of education, compared to other PISA countries. All of these comparisons are summarized in Table 2.4.

Table 2.4 Quality vs. Quantity in Mexican Education

	Education spending/GDP (%GDP)	Gross Secondary School Enrollment (%)	PISA scores
Mexico (0-1)	1.04 (1.31)	-14.9 (1.37)	-53.2 (1.83)
Standard deviation of policy variable	1.37	19.2	39.1
<i>N</i>	30	32	33
<i>R</i> ²	.30	.34	.50

NB: The sample consists of democracies reporting 2003 PISA scores. A positive Mexico coefficient indicates the amount by which the actual Mexico outcome exceeds comparator countries; a negative, by how much it falls short of comparator countries. *t*-statistics in parentheses. Coefficients for control variables (land area, income per capita, ppp-adjusted, constant 2000 dollars; percent population under 14 and percent population in rural areas) and constants not reported. White-corrected robust standard errors.

POLITICAL OBSTACLES TO DEEPENING PRO-POOR POLICIES

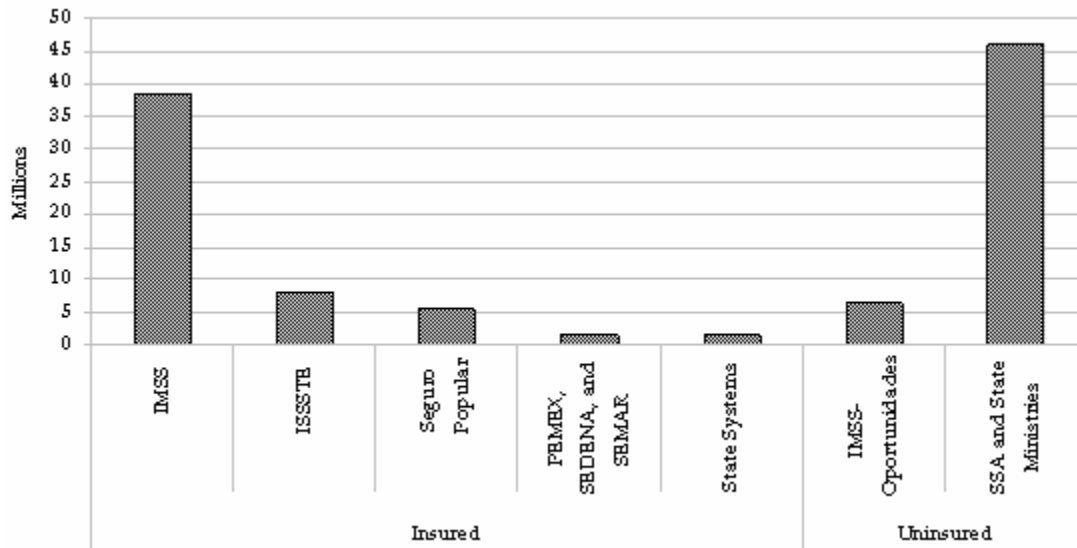
2.15 The broad trends reflected above suggest that the pressures of competitive elections have not had a dramatic effect on the extent to which public policy in Mexico serves the poor majority. Numerous examples of reform efforts since 2000 indicate that, despite the political pressures to appeal to voters broadly, vested interests have in many areas continued to be an immovable obstacle to reform. Several of these cases are reviewed here.

Social Service Delivery

2.16 Under the period of PRI hegemony, a relative minority of formal sector workers were offered limited social protection, while a large portion of the population was left

unattended. Even today, an estimated 60 percent of the working population has no insurance coverage and either shoulder the burden of high health expenditures or have to resort to poor quality State-provided health care. These are concentrated in poorer southern regions of the country. In contrast, formal sector workers (those unionized through the old corporatist structure) benefit from one of several insurance schemes, the most important of which is the Mexican Social Security Institute (*Instituto Mexicano del Seguro Social* – IMSS). The uninsured population is attended by facilities run by the Ministry of Health (SSA) but the quality of care at these facilities tends to be worse than the IMSS facilities, especially in terms of waiting time (World Bank 2006b).

Figure 2.1 Population by Institution of Affiliation, 2004



Note: Some people are affiliated with more than one institution.

Source: Salud: México 2004, reported in World Bank (2006b).

2.17 One effort to inject greater equality of access to health care was the attempted reform of the pension regime for the workers of the IMSS. This episode (see Box 2.1) demonstrated strong political power of a public sector union in going against a law that obtained bipartisan support of PAN and the PRI.³⁰ Although IMSS beneficiaries are not the poorest of the poor, they represent significant portions of the Mexican population (more than 40 percent) and the private sector workers (more than a quarter), as well as 800,000 businesses. That the 370,000 unionized workers (including 120,000 retirees) were able to dilute the reform content because of their ability to resort to extra-institutional measures (e.g., threat of strike) illustrates well the influence such groups exercise in Mexico even after the end of the corporatist single-party regime.

³⁰ PRD and other left-leaning parties opposed the reform and supported the IMSS Union.

Box 2.1 Politics of IMSS Reform

In 1995, the Zedillo administration was able to introduce a significant structural change to the country's private sector pension system by changing it from a pay-as-you-go scheme to one where individuals chose a privately-managed individual retirement account with a minimum benefit guaranteed by the government. The reform passed, even though it affected a large number of private sector workers. Almost a decade later, in the face of IMSS's continued financial difficulties, the Fox administration proposed a reform aimed at adjusting the highly generous pension scheme of the IMSS's own employees. The existing scheme allowed the IMSS workers to retire after 28 years (compared to 40 years for the general Mexican workers) at the age of 53 (compared to the official retirement age of 65), and received an average monthly pension payment of US\$1,500 (compared to US\$210 for a retired private sector worker with the same salary level as IMSS workers at the time of retirement). According to IMSS's own data, for each peso the Institute spent to expand the infrastructure of medical facilities to attend the 45 million beneficiaries, it spent 3.7 pesos for pension benefits for 120,000 IMSS retirees. To cover the financial gap, IMSS turned to the contributions made by affiliated beneficiaries, which were intended to cover the expenses of their individual healthcare benefits. In 2003, IMSS paid US\$1.83 billion for its retiree benefits (including their health care benefits), of which US\$1.31 billion came from these contributions by private sector workers and employers (IMSS 2004).

The government's reform proposal was intended to correct this financial imbalance by tightening the eligibility criteria (e.g., later retirement age) and reducing benefit levels (e.g., from 130 percent of the last salary to 100 percent). The reform bill, originally proposed by PRI, was passed as law in August 2004 with joint support of PRI and PAN. The new law delegated to the Executive definitions of specific details of the new pension scheme. A protracted process of negotiations between the Executive and the IMSS workers' union ensued, during which the latter resorted to a variety of tactics ranging from simple refusal to come to the negotiating table to mobilization of allied unions (particularly the union of public sector workers SNTSS) and a threat of a national strike. In the meantime, the absence of an agreement prevented the IMSS from filling vacant posts for doctors and nurses, which reached 17,000 vacancies. It was only after the resignation of the IMSS Director General in October 2005 that the government was finally able to reach an agreement with the union. Although the agreed package was reasonably close to the government's original proposal, the episode demonstrated the organized labor's ability to resist reforms that would bring benefits to the population in general, while concentrating the cost on a privileged minority.³¹

2.18 Another illustration of the political difficulty in improving effectiveness of Mexico's social policy is the series of attempts to reform the country's education system. These date back to the early 1990s and have continued into the early 2000s. Every time

³¹ The original reform sought to (i) reduce the retirement benefit from 130% to 100% of the last salary, (ii) increase the workers' contribution to their retirement fund from 3% to 10%, (iii) index the retirement benefits to the general consumer price index and inflation rather than to the increase of the active workers, and (iv) raise the retirement age to 65 (as opposed to 60) or 35 years of service (as opposed to 28 for men and 27 for women). Instead, the compromise package achieved (i) the reduction of the retirement benefit to 100% of the last salary, (ii) gradual increase of the worker contribution from 3% to 10% over seven years, and (iii) and extension of the minimum years of service to 35 years for men and 34 years for women (but maintaining the retirement age at 60).

the government initiated a reform to make the sector more performance oriented so as to improve education quality, it was forced to reach compromises with the powerful National Teachers' Union (SNTE). Compromise in contentious policy areas such as education reform is to be expected; in these cases, however, the result of compromise was almost no reform.

2.19 The 1992 episode of education decentralization under the Salinas administration is particularly telling because even during the height of the political power enjoyed by the Salinas presidency – the PRI registered an impressive victory in the 1991 mid-term congressional elections – it was not possible for the strong president (with all his “meta constitutional” powers at his disposal) to impose his will fully on the powerful teachers’ union.³² After closed-door negotiations between the government and SNTE, the agreements were reached to decentralize the structure of primary and secondary education, and separately, to introduce a performance evaluation scheme as a basis for determining teacher salaries. While decentralization proceeded, the teacher’s union retained a significant say over teacher salaries and employment conditions through centralized collective bargaining at the national level. SNTE also managed to dilute the content of the teacher incentives program by making sure the weight of performance evaluation in the formula for salary determination was relatively limited (35 percent of the total initially). This performance incentive scheme, for all its intents and purposes, has been made spineless. “SNTE’s considerable degree of capture of state education administrations made sure that the implementation of the instrument remained in union hands for all practical purposes” (IDB 2006, p. 230).

2.20 In 2002, a decade later in a different political environment, the Fox administration introduced several initiatives aimed at improving coverage and quality of public education. These include a new law that made three years of pre-school education mandatory, the Social Commitment for Quality of Education initiative, which, *inter alia*, proposed to use standardized test scores as a performance benchmark of the education sector, and a law that mandated increases in the education budget to 8% of GDP, which would mean increasing the share of education expenditures from 16% of the total public spending to 35% in the absence of an overall revenue increase.³³ The proposal to introduce standardized test scores as a criterion for evaluating teacher performance faced union resistance. The negotiations over the bill lasted a year and half without reaching a negotiated settlement. Thus the Institute for Educational Evaluation was created by a presidential decree, which apparently incorporated all of the union’s demands (Pardinas 2004). It thus appears that after a decade and with the more

³² Salinas did succeed in replacing the union head accused of corruption and other illegal activities (e.g., as an alleged mastermind of assassinations of dissident teachers) with someone who was closer to him. The new SNTE head subsequently became the president of the PRI (Grindle 2004).

³³ Eight percent of GDP is clearly an unrealistic target not only because of Mexico’s low overall public spending, but also in comparison to other Latin American countries. Among the larger countries in the region, only Brazil currently spends more than 5 percent of GDP on education, whereas Argentina, Chile and Colombia spend around 4 percent.

competitive electoral environment, the same difficulty the Salinas administration faced in making the teaching corps more performance oriented remains, due to the strong presence of the union that resists such changes including proposals to subject teachers to external performance evaluations. Teachers' union's influence is also reflected in their capacity to negotiate salary increases. From 1998 to 2001, teachers' salaries increased 52.4% in nominal terms (over 13% per year on average), while their benefits increased 9.1%. In fact, since at least 1993, teachers' salary increases were always higher than the GDP growth; but this has had no discernible effect on teaching quality as mentioned before.

Fiscal Efforts for Redistributive Policies

2.21 Other elements of the Fox initiatives required a considerable boost in public spending. However, increases in social spending registered in the last several years have been achieved without corresponding fiscal efforts – the re-allocation of public resources took place from debt payments, which dropped from 24% of total spending in 1995 to 14% in 2002, and from squeezing infrastructure spending (less than 5% of the total). Further reforms of social policies require augmenting the state's fiscal capacity so that it can be expanded further without affecting other spending priorities such as infrastructure investments, which are also in shortage and yet are critical for enhancing the country's economic competitiveness. A solid national consensus on the need to deepen social policies and augment the public sector's capacity to provide vital infrastructure would inevitably have led to a discussion on measures to enhance government revenues. It turns out, however, that Mexican politics is still not very conducive to allowing a larger state, and this is apparently not because of the Mexicans' ideological opposition to an interventionist state. A nation-wide survey conducted in late 2006 indicated that a majority (57 percent) of the respondents preferred a welfare state to a minimalist state.³⁴

2.22 A logical course of action for a government intent on satisfying growing citizen demands for pro-poor policies would be to raise tax revenues. Increased electoral competitiveness where a majority of the voters are poor and thus would benefit from such policy – especially if incidence of the additional taxes falls mostly on the rich – might provide the government with political incentives to raise taxes.³⁵

³⁴ *Encuesta Nacional de Vivienda*, Parametría, November 2006 (N=1,200). The question posed was "Some people think the state should economically support the citizens; others think citizens should not depend so much on the state. What do you think?" Thirty-five percent of the respondents chose "the citizens should not depend so much on the state."

³⁵ In contrary cases, prominent recent contributions to our understanding of growth and democracy (e.g., Acemoglu and Robinson 2006 and Engerman and Sokoloff 2002) point to the reluctance of elites to allow for redistribution and the provision of public goods that benefit all citizens. This reluctance increases in countries with large deposits of natural resources, where the rents that could be lost to redistribution are greater. Once competitive elections occur, however, elites lose control of policy and non-elites approve of taxes on the elites to finance public goods and redistribution.

2.23 Democratic pressure is not the only reason why governments might attempt to reform tax systems. Even before elections became competitive, several tax reforms have been attempted since the 1960s. Some of them were outright unsuccessful. For example, under the presidencies of Díaz Ordaz (1964-70) and Echeverría (1970-76) business leaders affiliated with the PRI mobilized to block tax reforms proposed by the PRI leadership (Lehoucq 2006 p. 21). Others have fared better. In 1989, President Salinas succeeded in passing a minimum 2 percent asset tax on business; eliminating special provisions for minor tax payers, which affected 250,000 registered taxpayers; and repealing the Special Tax Basis (STB) for about 1.5 million firms. These legal changes eliminated fiscal privileges benefiting 17 percent of all Mexicans (Elizondo Mayer-Serra 1994, p. 180).³⁶

2.24 The episodes of attempted Value Added Tax reforms under the Fox administration illustrate the political challenge of tax reform in Mexico today. Since 1980 the VAT has excluded food and medicines. In 2001, the government tried in vain to eliminate the VAT exemption on food and medicines and to strengthen the powers of tax authorities to prosecute delinquent taxpayers. In 2001, the administration packaged a proposed elimination of the VAT food exemptions, a reduction in the maximum income tax rate from 40 to 32 percent, and a transfer of 108 pesos per month to households with food expenditures reaching 50 percent of total expenditures. Only the income tax reform succeeded. Finally, in 2003, the administration tried once more to reform the VAT, this time proposing a rate reduction from 15 to 13 percent, allowing states to add a piggyback tax of up to two percent on the federal VAT, an eight percent production tax on exempted VAT items, and a reduction in the maximum income tax rate to 30 percent by 2006. These reforms failed.

2.25 Once again special interest influence seems to have played an important role both in explaining the minor revenue effects of apparently significant tax reforms and resistance to the tax reforms advocated by the Fox administration.³⁷ The political price of raising taxes or closing loopholes was to open other loopholes or lower other taxes, to the benefit of the special interests that benefited from the loopholes or low tax rates. For example, the VAT exemptions on food and medicine, interpreted narrowly, would have substantially increased the progressivity of the taxes. However, retailers successfully sued in the courts to get their products covered by the exemptions; as many as 50 percent of all retail items now have some type of VAT exemption (Lehoucq 2006).³⁸ As a

³⁶ Interestingly, in 1991, the Salinas government *lowered* the VAT from 15 to 10 percent, and then in 1995, President Zedillo secured legislative approval to increase the VAT from 10 to 15 percent.

³⁷ Tax revenues as a fraction of GDP fell from 11.8 percent in 1990 to 10.6 percent in 1994. They should have risen if the 1989 reforms had succeeded in increasing revenues. With the 1995 VAT reforms under President Zedillo, taxes on goods did jump as a fraction of total revenues, to 54 percent. However, this simply returned that fraction to its 1990 value. In addition, just as with the earlier reform, total tax revenues as a fraction of GDP were static.

³⁸ Although these exemptions appear to be judicially-driven, judges act in the shadow of the legislature: laws written loosely leave judges little choice but to grant broad exemptions.

consequence, the top two income deciles receive more than a third of the total benefits of the exemption and the bottom two deciles less than 10 percent.³⁹

2.26 Besides special interests' ability to get organized and oppose reforms, there is an indication that impetus for reforms suffers from weak credibility of politicians, especially when they promise higher taxes in exchange for better policies. The elimination of VAT tax exemptions would have been disproportionately paid for by the rich, but this was insufficient to induce popular support for them. Despite the argument that every peso of benefit that the poor received from VAT food exemptions was matched by four pesos of benefit to the rich, the PAN promises to spend revenues saved from abolishing these exemptions on the poor went unheeded, or simply not believed (Lehoucq 2006, p. 20).

Public Security Reforms⁴⁰

2.27 A burning issue that preoccupies a majority of Mexicans is public insecurity. Some polls show that concerns about public insecurity are even greater than about other traditional problems like unemployment, poverty, and corruption (see Table 2.5). Given the high level of expressed citizen concerns, governments that are responsive to voter demands would be expected to attempt measures to address crime and violence. Is this the case in Mexico?

Table 2.5 Main Problems of Mexico according to Citizens, 2001-2006

Main problem	May 01	May 02	May 03	May 04	May 05	May 06
Public Insecurity	16.7	18.1	20.1	10.6	28.9	26.4
Unemployment	15.9	15.7	11.7	24.9	17.0	22.1
Economic crisis	19.9	27.1	21.5	19.2	16.7	20.0
Poverty	12.0	13.4	18.2	12.2	10.4	11.9
Corruption	4.7	6.8	7.4	16.5	9.4	5.5
Drug addictions	1.3	3.5	3.3	2.0	3.0	1.8
Education	-	2.5	4.0	2.6	2.5	1.8
Bad government	2.0	1.1	2.7	1.7	1.4	0.3

Source: Consulta Mitofsky (2006).

2.28 Anecdotal evidence indicates that politicians do tend to prioritize anti-crime measures both during electoral campaigns and once in power. Both the federal government and sub-national governments such as the State of Chihuahua (which faces an "average" level of crimes) and the Federal District (which suffers from one of the

³⁹ If the food exemptions had been written narrowly and restricted to staple items, tortillas, for example, these figures would have been (roughly speaking) reversed. Instead, exemptions have expanded to encompass a large range of goods, many disproportionately consumed by the rich (Hernández Trillo 2005: 126-8).

⁴⁰ This section is based on background papers prepared for the IGR, namely, Artz (2006), Alvarado (2006a, 2006b), and Bergman (2006).

highest crime incidences) have launched various measures to fight crimes. But in all the cases examined, the effects of the measures have been limited. This is largely because reforms have refrained from tackling one of the most fundamental problems of governance of the sector; major institutional reforms of the police organizations that are generally considered corrupt and lacking in adequate professional capacities to be effective crime-fighting forces. These reforms are difficult for citizens to observe and slow to take effect. Instead, therefore, the tendency is for politicians to promote more visible measures, such as tougher penalties and physical investments in police (e.g., new uniforms, new equipment), despite significant skepticism among experts about the efficacy of these measures in controlling crime.

Box 2.2

Public Security Reforms in the Federal District

In the Federal District (DF), the López Obrador administration carried out a consultation process in 2001 for preparing a Public Security Integral Plan 2001-2006. Local business groups played an active role in the formulation of the strategy based on diagnostic work commissioned to Rudolf Giuliani. The strategy included several reform measures such as the creation of a Directorate of Internal Control, the implementation of the police management system Compstat (replicating the experience of the NY Police Department), the creation of a Geographic Information Center, the restructuring of management levels within the Public Security Secretariat, and even more important, the introduction of performance incentives for the police and the territorial redistribution of the forces. The reform implied a complete administrative restructuring of the Secretariat, renaming old police forces with new, citizen-friendly titles, such as community police; and developing some pilot community-run policing programs. In addition, the government submitted amendments to the legal code and new legislation to increase police custody, establish tougher jail sentences, and introduce administrative fines for acts against public order.⁴¹

The reform did have implications for the organizational structure of police forces and was successful in introducing performance incentives that aligned police officers' incentives with broader political goals. The voluntary retirement program facilitated the renewal of personnel, and led to dismissals of 2,000 police officers under accusations of corruption and abuse of power. A similar number of new officials were recruited. As yet, the reform has not modified internal control and accountability systems nor has it been successful in cleaning completely the police forces. A study carried out by Coparmex (2000) concluded that DF police chiefs and those in intermediate positions had not changed in the last twenty years. Whereas the reform made considerable progress, it has not altered either traditional structures of power within the police force or the source of the problems of criminality or police corruption. Crime and violence have remained in opinion surveys as the main concern for DF citizens.

Source: Arturo Alvarado (2006b)

⁴¹ Ley de Cultura Cívica.

2.29 One exception to this rule at the federal level was the creation of a new investigative police, AFI (*Agencia Federal de Investigaciones*). The AFI was created by executive decree in November 2001 to replace the discredited Federal Judicial Police (PJF). While this was one of the series of measures the Fox administration took in response to citizen demands for public security, the decision to reform the PJF also responded to pressure from the United States, which distrusted the PJF as a partner in its anti-drug efforts.⁴²

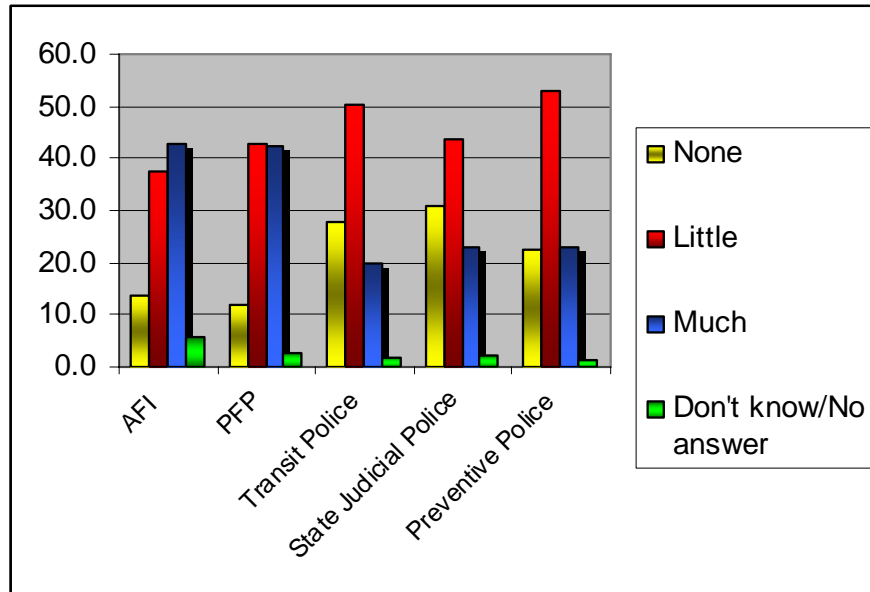
2.30 The AFI reform constitutes not only an attempt to modernize an important public security agency but also to control corruption and limit powers and influence of inefficient corporatist groups that took advantage of their extra-institutional influence to capture the sector. It entailed a comprehensive overhaul of the old planning and operations department of the Federal Judicial Police (PJF) in order to create an elite force to conduct criminal investigations.⁴³ Key to the reform was the cleansing of the new organization of those elements suspected of their involvement in corruption or ill-qualified for the job. Official sources indicate that almost 8,000 police agents were subjected to strict evaluation and screening processes. The criteria for recruitment into the AFI are now more rigorous, and the career structure of the agents is better designed under the Civil Service Career of the Attorney General's Office (PGR). In 2003, the Presidency's Government Innovation program recognized one of the AFI's programs, and the AFI's other internal processes are being certified with the ISO 9001-2000 standard. This is reflected in relatively positive image Mexicans hold of AFI (and the Federal Preventive Police, PFP), compared to state and municipal police bodies.⁴⁴

⁴² Arzt (2004), and Bergman (2006).

⁴³ This new organizational model was based on the principles of: a) professionalization of personnel; b) demilitarization of police functions; and c) utilization of modern techniques and instruments to improve analytical capacities for intelligence and investigation purposes. The AFI was also equipped with modern installations and state-of-the-art technologies. A new Information and Telecommunications System (SITE) started operating in 2003 to improve effectiveness in the investigations.

⁴⁴ However, it should be noted that only 3 out of 10 survey respondents had heard about AFI and PFP.

Figure 2.2 Citizen Confidence in Police



Source: *Tercera Encuesta Nacional sobre Inseguridad 2005 (ENSI-3)*, Instituto Ciudadano de Estudios sobre la Inseguridad A.C.

2.31 Exact information is not available regarding what exactly happened to the 8,000 agents after their evaluation. A considerable number are believed to have been fired, but a large number were apparently transferred (or found their own ways) to other police organizations, including in other jurisdictions. The legal difficulties of firing police officers are significant. In 1996, when the then Attorney General fired 703 federal police agents, he was subsequently forced to reinstate most of them after a court ruling favorable to the officers. Thus, instead of overhauling the law enforcement institutions completely, the government’s strategy with regard to the AFI has been to create an “island of excellence,” and to concentrate its investments on organizational development largely of this new agency, while passing the problem (i.e., officers who were fired from the AFI) to other police agencies within the public security system. Relatively successful reform in the AFI took place while other agencies show less progress.

2.32 In spite of its relative success, the AFI case also highlights the difficulties involved in dismantling the old structure of the enclave, even when the strategy adopted is to establish a parallel structure. Moreover, even within the AFI, vestiges of the past remain. A recent series of accusations and disclosures about corrupt federal agents is threatening to undermine the AFI’s reputation as an elite federal force.⁴⁵ In addition to the scandals, the Office of the Attorney General has released a report showing that far from being incorruptible, 1,493 of the AFI’s 7,000 officers (around one

⁴⁵ “Scandals Shake Mexico’s Confidence in Elite Drug Police”, *New York Times* December 28, 2005. “Drug Traffickers Corrupting Fed Agents”, *Washington Post* Aug. 25, 2005; “Mexican Attorney General: Drug traffickers corrupting federal agents”, *Associated Press*, August 24, 2005.

in five of the force) are under investigation for committing crimes and 457 had been indicted.

2.33 Legislation to generate more broad-based and fundamental reforms in the security sector has stalled. In March 2004, the Fox administration submitted to Congress a major legislative proposal for reforms of the public security and criminal justice system, built around three substantive pillars: (i) reform of the criminal justice procedures (e.g., introduction of the oral procedures); (ii) organizational reforms of the sector (e.g., constitutional autonomy of the PGR and unification of all federal police agencies under the Secretariat of Interior); and (iii) professionalization of the sector. The preparation of this comprehensive reform proposal was one of the achievements of the Secretariat of Public Security (newly created by the Fox administration).

2.34 The proposal was generally well-received by public opinion and experts. It was judged to be based on sound diagnosis, though some of its technical content generated controversies among specialists. Among the most contentious issues was the merit of unifying all the police forces. For example, even some critics who agreed on the need to reform the existing police agencies feared that creating a single “super” police agency in the current context would likely mean carry-over of the personnel, including those corrupt elements, into a single, very powerful entity, which might escape adequate democratic control. The experts generally coincided that more time and consultation/debates prior to the bill’s submission to Congress would have smoothed the way towards a final approval.

2.35 In response, Congress could have availed itself as a forum for such technical debates. The importance of the topic was evident, especially after the June 2004 march in Mexico City that demanded credible government responses to the public insecurity. However, Congress hardly moved. Several explanations for this have been offered, including the PRI’s and the PRD’s electoral calculations aimed at denying the PAN administration a major legislative achievement and the government’s unskillful handling of the legislative process. Suffice it to note here that whatever the specific reasons for Congress’ inaction, it is evident that political incentives for the legislators to reach an agreement were not sufficiently strong to overcome these other countervailing motivations, despite the overwhelming perception among the Mexicans of the importance of the issue and thus the initiative.

SUMMARY

2.36 Evidence so far shows that greater electoral competitiveness has begun to make politicians (and governments) more responsive to general voter demands. But this pressure is still dampened by countervailing forces. A minority of voters does press for such changes, but efforts to deepen social policies (e.g., by making teachers more performance oriented) and to expand the state’s fiscal capacities so that social services can be expanded without affecting other spending priorities face stiff resistance from

special interests that have long enjoyed privileges. There is also an indication that impetus for reforms suffers from weak credibility of politicians, especially when they promise higher taxes in exchange for better policies. The elimination of VAT tax exemptions would have been disproportionately paid for by the rich, but this was insufficient to induce popular support for them. Despite the argument that every peso of benefit that the poor received from VAT food exemptions was matched by four pesos of benefit to the rich, PAN promises to spend revenues saved from abolishing these exemptions on the poor went unheeded, or simply not believed (Lehoucq 2006, p. 20).

2.37 The political polarization (e.g., between poor and rich, between the north and the south, etc.) as reflected in the polarized voting patterns of recent years would weaken governments' credibility in the eyes of the voters who belong to the "opposite" social and political groups (e.g., PRD supporters who would benefit from PAN's tax reform proposal may not support it nonetheless because they don't believe PAN policies will benefit them). The use of fiscal resources for rewarding supporters and punishing detractors, a practice long exercised under PRI's one-party rule (Dias-Cayeros, Magaloni and Weingast 2003), may have embedded in an average citizen's mind that benefits of policies came not with the technical soundness of their content, but with the beneficiaries' political affiliations. To the extent maturing of a democracy is a learning process through which both politicians and voters learn to behave in a rational way in response to incentives that they face, it would not be surprising if Mexican voters continued to behave as though the political system still operated in similar ways as it did under the 71 years of a single-party rule.

3. ECONOMIC LIBERALIZATION, COMPETITIVENESS, AND GOVERNANCE

CONSTRAINTS TO ECONOMIC COMPETITIVENESS

3.1 Apart from better public services (especially public security), a burning concern for many Mexicans is slow growth and job creation. Many studies point to obstacles to entrepreneurial activity in Mexico as responsible for slow growth. A survey from *Centro de Estudios Económicos del Sector Privado* (2005) finds that the two largest obstacles to business development identified by firms in Mexico are public and private monopolies, and the Global Competition Review ranked Mexico near the bottom, with a score of 2.25 which is only better than Greece and Argentina (ranges from 0-5).⁴⁶

3.2 The World Bank's Doing Business Indicators offer a snapshot of selected regulatory obstacles to entrepreneurial activity and job creation across a large number of countries. As in the case of the social policies noted in Chapter 2, the picture here is mixed. Mexico does significantly better than average with respect to the costs of starting and closing a business, exporting and importing, and certain licensing costs. However, with respect to creditor and investor rights, labor regulation, and the liability of company directors for malfeasance, Mexico is significantly below the world average. Mexico makes it easy to open small enterprises, but the costs to enterprises of gaining access to labor and financing rise significantly for larger enterprises.

3.3 Table 3.1 compares costs to business activities in Mexico to those in other countries with competitive elections, taking into account possible exogenous constraints on political decision making, such as income and population and geographic characteristics. The results indicate that the costs of starting a business are 38.5 percent of income per capita *less* than in other democracies. However, all aspects of employment regulation are significantly more inflexible in Mexico.

3.4 The magnitudes reported in Table 3.1 are also similar to the deviations of Mexico from the whole world averages (both democracies and non-democracies) in 2005. For example, the investor protection index in Mexico is 1.4 points (out of ten) less than the world average – one full standard deviation lower. The creditor protection index is almost three points (out of ten) less than the world average. Although tax payments are low in Mexico, the tax bureaucracy is much more cumbersome: the number of tax payments is more than one half of a standard deviation (13) higher for firms in Mexico than the average elsewhere. Again, though, some comparisons are favorable. For

⁴⁶ *Global Competition Review*, Volume 6, Issue 6, June 2003.

example, the time it takes to export out of Mexico is 14 days, or almost one standard deviation less than the world average.

Table 3.1 The Environment for Job Creation in Mexico, Compared to Other Countries with Competitive Elections (2004)

	Costs of starting a business/GDP per capita (%)	Index of difficulty of firing workers (0 – 100)	Costs of firing a worker/GDP per capita (%)	Index of employment rigidity (0-100)
Mexico (0-1)	-38.2 (4.56)	33.10 (7.87)	16.17 (1.87)	9.78 (3.12)
<i>N</i>	85	84	85	84
<i>R</i> ²	.42	.14	.20	.13

NB: A positive Mexico coefficient indicates the amount by which the actual Mexico outcome exceeds the predicted; a negative, by how much it falls short of the predicted. *t*-statistics in parentheses. White-corrected robust standard errors. Constants and coefficients of control variables (per capita income, ppp-adjusted in constant 2000 dollars; land area; and percent of the population that is rural or younger than 13) are not reported.

3.5 Table 3.2 examines other bottlenecks to growth, based on how much investment could be expected to result from improvement in a wide range of areas where public or private sector monopoly or oligopoly limit healthy competition (e.g., finance, energy) and innovation (e.g., education) as well as those for which structural reforms have long been advocated (e.g., tax, labor).

Table 3.2 Constraints to Competitiveness⁴⁷

Subject areas	Impact on investment per worker of a 10 percent improvement in the variables behind each subject area
1) Competition environment	7.5 %
2) Taxes and tax regulations	7.1 %
3) Regulatory and investment climate	6.8 %
4) Education	6.0 %
5) Trade facilitation and transport / logistics	5.8 %
6) Corruption	4.7 %
7) Innovation	3.8 %
8) Finance	3.6 %
9) Energy	2.7 %
10) Labor market	1.9 %
11) Macro environment	1.0 %

Note: The percentages are point elasticities, which reflect the effect on investment per worker of a 10 percent isolated improvement in each variable. Simultaneous interventions could have multiplicative effect.

Source: World Bank (2006d).

MONOPOLIES, COMPETITIVENESS, AND GOVERNANCE

Monopolies as Constraints to Economic Competitiveness

3.6 A particular feature of Mexico's economic structure that limits its competitiveness is the degree of market concentration in key economic sectors and the existence of public and private monopolies, especially in utilities. The reforms introduced during the 1990s aimed at raising fiscal revenue, promoting economic efficiency, broadening stock ownership, attracting foreign capital, providing more opportunities to introduce competition and strengthening the regulatory framework in the case of natural monopolies. However, in some cases the reforms led to increased market concentration and failed in enhancing the competitiveness of the economy as a whole. In some cases, privatization meant a mere change of ownership, replacing public monopolies with private ones, without an effective regulatory framework in place and strong regulatory agencies that could enforce more competitive conditions.

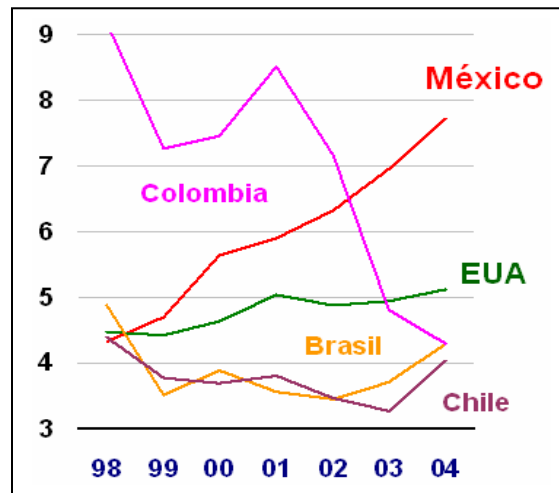
3.7 In the case of the remaining public monopolies, such as electricity, inefficiency and high costs entailed in maintaining them create a heavy burden for Mexican producers that want to compete in international markets, through increased production costs and unreliable supply. Business opinion surveys give Mexico the lowest ranking

⁴⁷ Impact numbers for single effects or isolated improvements in each category. A broad package of reforms across most of the high-impact categories could have a positive bundling effect. In other words, the interaction between the individual variables should create an overall impact that is substantially larger than the sum of the individual improvements.

of any OECD country in terms of energy efficiency and adequacy (Guerrero et al 2006). Natural gas, electricity and fuel oil prices are amongst the highest in the world. High electricity costs, when adjusted for fluctuations in frequency and voltage, result in effective costs that are 10 to 60 percent higher than in the U.S.

3.8 Inadequate investments in energy infrastructure have had a significant negative impact on Total Factor Productivity Growth in Mexican manufacturing (World Bank 2005). The performance of state-owned electricity company, *Comisión Federal de Electricidad* (CFE), for example, is very poor when compared to other Latin American companies. Mexico's electricity costs are growing and are now among the highest in Latin America (Figure 3.1.)

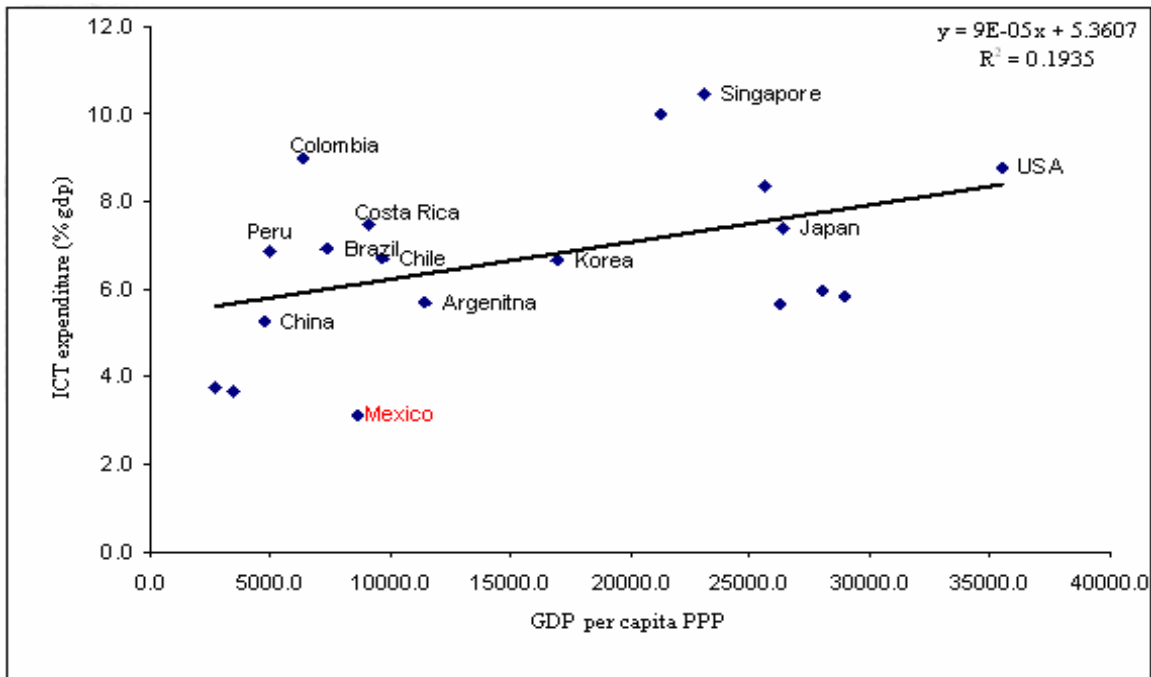
Figure 3.1
Electricity Cost USDcents/KWh



Source: World Bank (2006d).

3.9 This difficult situation is also present in telecommunication, which is a private monopoly. Despite impressive growth of information and communications technologies (ICT) in the 1990s, Mexico lags behind other Latin American and OECD countries in investment in ICT (Figure 3.2.) Mexico's level of ICT expenditure as a share of the overall economy (3.1 percent) is significantly below OECD countries such as Japan (7.4 percent), US (8.8 percent) and New Zealand (10 percent). It is also nearly half that of Chile's and Brazil's rates of 6.7 percent and 6.9 percent, respectively.

Figure 3.2 Investments in Telecom



Source: Guerrero, Lopez-Calva and Walton (2006).

3.10 Low investment in ICT in Mexico has meant that fixed line growth has not kept pace with comparable countries and the digital divide between rural and urban areas has increased.⁴⁸ Southern states are falling behind the rest of the country in ICT. Costs are also high when compared to other countries. Telmex dominates the long distance, local and cellular markets. Its net profit margins are more than twice its closest rival's, and reflect telephone charges that are significantly higher in Mexico than elsewhere in Latin America, especially in local prices for business (Table 3.3). Business telephone charges (factoring installation costs, monthly fees, and per minute rates) are over 3 times in Mexico than in Argentina and 4 times greater than in Brazil.

⁴⁸ Countries with higher levels of investment in ICTs experience higher economic growth and social development. See OECD (2004).

Table 3.3 High Telephone Rates (US\$)

	<i>Monthly rate Commercial</i>	<i>Monthly rate Residential</i>	<i>Cost per connection Residential</i>	<i>Cost per call three minutes</i>
Mexico	18.35	14.51	104.73	0.14
Argentina	12.94	4.56	51.72	0.02
Chile	9.20	9.20	43.95	0.10
Brazil	13.71	7.72	13.81	0.05
Korea	4.36	4.36	50.35	0.03

Source: World Bank (2006d).

3.11 Effective regulatory frameworks, including antitrust laws, and independent regulatory agencies with wide-ranging supervisory powers are important to increase efficiency, especially in highly concentrated industries, such as airlines, banking, telecommunications, petroleum exploration and refining, where usually one or two firms dominate the markets. In these industries, unless an effective regulatory framework is in place to safeguard the public's interest against monopolistic abuses, the dominant firms may engage in anti-competitive behavior and exert undue control over key economic decisions (without public accountability). However, regulatory agencies in Mexico are weak and lack autonomous power.

3.12 In the electricity sector, for example, reforms passed in 1992 and 1995 allowed for private sector participation in electricity generation, provided that electricity is sold to the vertically integrated public sector company, CFE.⁴⁹ The same reforms introduced a regulatory agency, the *Comisión Reguladora de Energía* (CRE). However, CRE's main powers are limited to specific functions related to the regulation of electricity generation and gas supply by the private sector. Unlike in many other countries, the regulator does not regulate utilities. CFE and LFC (*Luz y Fuerza del Centro*, the distribution company that serves the metropolitan area of Mexico City) thus are outside the scope of CRE.⁵⁰ Similarly in the telecom sector, COFETEL (*Comisión Federal de Telecomunicaciones*) was set up with few teeth. It makes recommendations on practices that hurt consumers to the Minister, rather than directly imposing sanctions. Under President Fox the Minister was himself an ex-employee of the principal firm in the sector, Telmex. While there is nothing illegal in this, it raises concerns over the extent of independence from the industry that it is supposed to regulate.

3.13 Mexico's weak regulatory structures are not limited to these two sectors. In general, regulators in Mexico fall into two categories: (i) de-concentrated bodies, which

⁴⁹ As required by the Constitution, the electricity sector remains federally owned or controlled.

⁵⁰ It is considered good practice in the electricity sector to have an independent system operator in charge of transmission and dispatching. In Mexico, however, CFE itself is in charge of the operation and administration of the National Power System.

have technical and operational autonomy but report to sector ministries; and (ii) departments within sector ministries. None of the regulating agencies is fully autonomous, since their budgets and personnel depend on the executive branch. The least autonomous are the transport regulators, which are administrative units within the Department of Transport. All other regulators function as de-concentrated bodies.⁵¹

3.14 One of the relative exceptions is the Federal Competition Commission (CFC), which was set up with greater structural independence, with commissioners appointed for extended terms. It has the capacity to make decisions on monopolistic practices, and impose fines or changes in firm behavior. These, however, ultimately depend on the judicial system and the willingness of other branches of government to follow its recommendations. The inability of the CFC alone to regulate anti-competitive behavior was exemplified in the recent case of the Radio and Television law, the so-called “Ley Televisa,” approved by Congress on March 30th, 2006. The law strengthens market power of current monopolies despite the recommendations against its content made by the CFC.⁵²

Politics of Industrial Concentration

3.15 The presence of public and private monopolies and oligopolies that constrain the country’s economic competitiveness and the weakness of regulatory agencies is not a coincidence, or a natural result of Mexico’s economic development process. This is a result of the specific ways in which Mexico has been governed since the early 20th century. Economic and financial liberalization pursued since the early 1990s might be expected to have changed this historical pattern.⁵³ But, as we have seen, this has not brought about the expected impact on efficiency and competitiveness of the economy as a whole. Nor have these reforms been able to break the pattern of economic concentration and regional polarization that characterized the Mexican economy before the political transition started (Gordon 1997).

⁵¹ These include CONAGUA (*Comisión Nacional del Agua*), OD Environment Department, administers and preserves water, CRE (*Comisión Reguladora de Energía*), OD Department of Energy, regulates natural gas and electricity, COFETEL (*Comisión Federal de Telecomunicaciones*), OD Transport and Communication Department, regulates telecommunications, CNBV (*Comisión Bancaria y de Valores*), OD Treasury (SHCP), supervises and regulates banks and the financial sector, CNSF (*Comisión Nacional Seguros y Finanzas*), OD Treasury, supervises and regulates insurance, CONSAR (*Comisión Nacional de Sistemas de Ahorros para el Retiro*), OD Treasury, supervises and regulates pension funds, CFC (*Comisión Federal de Competencia*), OD Department of the Economy, sanctions monopoly practices and oversees competition and COFEMER (*Comisión Federal de Mejora Regulatoria*), DO Department of the Economy, ensures transparency in the elaboration and implementation of paper regulations (*trámites*).

⁵² Televisa is owned by one of the most powerful families in Mexico.

⁵³ The reforms have included trade and capital account liberalization, privatization, increased private sector participation in key sectors of the economy, tax reforms, changes in labor market structure, capital market liberalization, and pension system reforms, aimed at transforming a closed, heavily regulated economy with high government intervention into an open, market-driven economy.

3.16 A telling example of this historical pattern is the financial sector, where the banking system has been highly concentrated in a few banks and lending has gone to a few large firms, many of which had relational lending at favored terms. The reforms of the post-94 crisis cleaned up the system, and tightened the banks' incentive to be more prudent with their portfolio management. At the same time, these same reforms led to increased concentration, and the share of assets of the 5 largest banks rose from 74 percent in 1994 to 88 percent in 2001. Mexico's is today one of the most concentrated banking systems in the world (World Bank and IMF 2005).

3.17 This increased market concentration does not necessarily imply an uncompetitive system. However, evidence shows that banking liberalization in Mexico did not reduce intermediate margins, improve credit allocation and spur financial deepening. In Mexico today most firms still lack access to credit. This may be partly because Mexico's financial sector policies since 1995 have concentrated on managing the effects of the crisis. In order to avert the systemic crisis, the deposit insurance institution, the FOBAPROA, purchased a large share of overdue loans worth close to US\$100 billion in exchange for government certificates. Unfortunately, the term for the bonds was "too favorable" and thus reduced the incentives for banks to lend. Before the banking crisis in 1995 Mexico was just behind Chile in terms of banking credit to the non-financial private sector as a percentage of the GDP, while in 1999 Mexico is compared to less developed countries like Ecuador and Colombia. Another indicator of banking efficiency is the net interest margin. Higher values of net interest margin indicate a higher spread on deposit and lending rates and therefore lower efficiency. The net interest margin in Mexico did not decrease after the bank privatization in 1992 (Gonzalez-Anaya and Marrufo 2001).

Box 3.1 The Role of Special Interests in Mexico's Banking Sector

The historical development of Mexico's banking sector illustrates well the symbiotic relations between the government and a segment of the economic elite of the country over the single-party system. The legal framework erected high entry barriers and thus protected the interests of those who were already established in the sector. Thanks to limited competition, banks were able to engage in non-competitive behavior, including holding of portfolios mostly composed of stocks owned by their own directors and loans to other firms also owned by the directors themselves. This arrangement limited availability of credits to small and medium-sized firms without "connection" and to households and small farmers (Haber 2005). By the time the bank privatization began in 1991, four banks controlled 70 percent of total bank assets (Haber 2005). After the 1991-92 privatization, lax supervision by the government and a particular accounting rule that allowed the banks to disguise some of the poorly performing loans cultivated the ground for the eventual collapse in December 1994, when the peso devalued massively (so-called Tequila Crisis).

The government response to this crisis offers an additional illustration of the extent of special interest influence in Mexico, but also of the growing role of electoral accountability. Prior to the peso devaluation of 1994, one-third of the loans made by Mexican banks had come to be foreign-exchange denominated. Unfortunately, a large fraction of the borrowers did not have

foreign-exchange denominated earnings. With devaluation, the peso value of their loan obligations doubled, they defaulted, and banks became insolvent (Haber 2004).

The government responded to the crisis with a massive bailout, both direct (including recapitalization of the banks through the purchase of non-performing loans) and indirect (support to bank borrowers). In part, the government response was intended to prevent the economy from succumbing to a sudden and dramatic credit crunch as insolvent banks closed their doors. However, the response also showed remarkable generosity towards special interests that does not seem to have been consistent with the public interest.

La Porta, et al. (2003) show that 20 percent of all large loans in the three years following the onset of crisis (1995-98) went to bank directors. They carried low rates of interest (four percentage points lower than those made to comparable outside borrowers); had a 33 percent higher probability of default; and had a 30 percent lower collateral recovery rate. These loans were originally ineligible for purchase by FOBAPROA, the state agency charged with responding to the crisis, but this restriction was subsequently relaxed.

Responding to the public interest, 15 banks were “intervened”: management replaced, shareholder value stripped away, and the banks’ assets sold or merged with other institutions. However, these actions were the exception and represented no real losses for the shareholders, since the banks were in any case insolvent. Instead, a truer picture of the treatment of special interests was that recovery of collateral was sufficiently weak that by June 1999, the government had spent 15 percent of GDP – \$65 billion – on the bailout program. Much of this money indirectly subsidized defaulted loans taken out by some of the richest families in the country (Haber 2005).

These actions were widely observed by voters and many attribute the PRI’s loss of majority status in the Congress in 1997 precisely to a voter backlash (Haber 2004). Moreover, once in place, the PAN-controlled Congress delayed the 1998 budget for 9 months until its questions about FOBAPROA were answered and FOBAPROA was replaced by a new and more autonomous agency.

3.18 Relations between the state and big businesses have taken a new turn since the 1980s, as a result of the reforms pursued since then, especially the privatization program generally considered among the most aggressive in the region. Privatization in Mexico covered a variety of sectors ranging from the financial sector as the banks that had been nationalized in 1982 were re-privatized, and transportation (e.g., airlines) and communications (telecom) to manufacturing (steel).

3.19 In the airline industry, for example, the government privatized both Aeroméxico and Mexicana airlines over the 1988-2005 period,⁵⁴ and dismantled and restructured the regulatory framework that had been in place for the better part of four decades. It promoted competition by easing entry restrictions for domestic carriers into heavily-traveled trunk routes and increasing the number of international-Mexico City pairs that

⁵⁴ Technically, Aeroméxico was never privatized but declared bankrupt by the government in October 1988 and its assets were acquired by Aerovías de México. Mexicana was privatized that same year and government kept 40% of the capital. The privatization process was completed in 2005.

foreign carriers could serve.⁵⁵ The initial effects of the reform were, on balance, positive for the new shareholders and the air traveling public as evidenced by the reduction in both Aeroméxico's and Mexicana's overall costs and the improvement in the quality of their service.⁵⁶

3.20 Perhaps the most important and beneficial aspect of the privatization and deregulation of the airline industry was the entry in 1991 of three new airlines – Taesa, Aviacsa and Saro – into several of Mexico's major trunk routes, offering greater competition to the two incumbent airlines.⁵⁷ However, in 1993 Aeroméxico's acquisition of a 55-percent ownership stake in Mexicana changed the competitive landscape of the industry. With the merger and consolidation of operations of the two carriers (although they maintained separate brand names), Aeroméxico and Mexicana took control of more than 70 percent of the domestic market for air travel, and almost completely controlled the most traveled trunk routes. In fact, the two carriers agreed to coordinate fares, introduce frequent flyer programs (to increase customer loyalty), and share ground services and crews. The merger of the two airlines escaped antitrust enforcement because Mexico's new antitrust law did not go into effect until four months after the merger had taken place, and many industry analysts observe that the merger took place, in large measure, in order to head off passage of the impending legislation.

3.21 Taesa and Saro could not compete with the new giant and went bankrupt in the late 1990's. Taesa was substituted in 2001 by Azteca, which is still operating. Aviacsa managed to survive and increase its market share through aggressive promotions. The split of Aeroméxico and Mexicana in 2006, when Mexicana was privatized,⁵⁸ has opened a way for the entry into the market of low-cost airlines such as Interjet and Volaris, launched in late 2005 and early 2006 respectively.⁵⁹ Although the entry of these small airlines has not succeeded in breaking Aeroméxico-Mexicana's grip, it has shaken it to the point where Mexicana now has a low-cost airline itself, Click. It is becoming more common to find discount fares for the main domestic destinations, which shows the benefits that further liberalization of the market could bring.

3.22 Telecom represents another sector where economic effects of the "liberalization" measure, privatization of the state-owned Telmex, have been more limited compared to telecom liberalization in other countries (Clifton 1999). Although the privatization did improve the situation from the dismal performance of the previous monopoly by

⁵⁵ Foreign carriers, however, were, and are currently prohibited from serving domestic city pairs.

⁵⁶ Aeroméxico increased on-time arrival from 75% in 1988 to 95% in 1991, while Mexicana raised its on-time arrival from 73% in 1989 to 86% in 1991

⁵⁷ Taesa's approach was to offer no-frills service, similar to the strategy of Southwest airlines in the United States.

⁵⁸ Mexicana is now part of Grupo Posadas.

⁵⁹ Interjet is 100-percent Mexican. Volaris has domestic and foreign investment; domestic investment comes from Televisa and Inbursa, and foreign investment comes from TACA, Discovery Americas I, and the International Finance Corporation.

increasing access to telephone services, especially for the lower income groups, the telecom privatization in Mexico created legal barriers to entry in the concession title of Telmex and retained the company as a vertically integrated monopoly, in the place of the former public monopoly.⁶⁰

3.23 In 1995, the government introduced a bill later passed as the Federal Telecommunications Law. Besides creating the rather weak regulatory agency, COFETEL, the 1995 Law restricted foreign ownership to 49% and applied to all operators except IUSACELL, which had previously been sold to a Canadian investor. The limitations to foreign control were imposed in Congress by PRI legislators, particularly those of the labor sector. However, President Salinas was also in favor of the original inclusion of the Mexican control clause in the concession of Telmex apparently because of his interest in developing strong Mexican business groups (Murillo 2001). The effect of this restriction was to increase the value of Mexican partnerships for foreign investors wanting to enter the market, thus subsidizing domestic business.

3.24 The case of the Telmex privatization vividly shows the political dimension of Salinas' privatization strategy. The government's decision was driven primarily by the fiscal consideration (i.e., raising revenues for the government in the short run), but academic accounts of the case also indicate that accommodating to labor interests, at least to those unions friendly to the government, was also an important consideration for the government.⁶¹ Thus, the government agreed to give away some ownership concessions to the labor union *Sindicato de Telefonistas de la República Mexicana* (STRM). It was a reciprocal arrangement between the government and STRM (with the consent of the management), following a classic corporatist style of "back-door" negotiations. The union made several concessions to the government and management in a mid-1989 memorandum of agreement, which included an acceptance of the management's more flexible use of temporary labor, increasing flexibility within the company by consolidating departments and reducing job categories, and reducing labor's involvement in managerial decisions. In exchange, the government and the management promised not to dismiss any existing employee due to privatization, gave employees wage hikes in 1989 in conjunction with the redefinition of job categories, and offered subsidized employee-owned shares (4.4%) that were syndicated and

⁶⁰ According to the head of the privatization unit, the telecommunications privatization was used to maximize revenue, to open the international financial markets for the Mexican companies, to include workers in the process, and to retain the company as Mexican (Rogozinski 1997).

⁶¹ It should be noted that Salinas also adopted a carrot and stick approach to adjusting government-union relations in the education and the petroleum sectors, traditional strongholds of the PRI labor faction, by forcefully replacing the heads of SNTE and STPRM (*Sindicato de Trabajadores Petroleros de la República Mexicana*).

administered by the union until their total payment and the rest of the shares went public in the following years.⁶²

3.25 Transfers of asset ownership in major sectors such as airlines and telecom are not purely economic decisions. Who ends up acquiring these assets and under what conditions can have lasting effects not only on the economic efficiency of the sectors and the economy as a whole, but on the distribution of political influence among key economic actors. The illustrative cases of privatizations discussed above hint at political calculations to favor large, established (or newly emerging) businesses (and organized workers), rather than consumers, or potential new entrants into the sectors. It is not possible to establish with certainty to what extent political considerations drove the government's approach to privatization in Mexico. As the case of South Africa illustrates, however, it is not uncommon for governments to approach privatization (or other economic policy reforms) with a strong dose of political considerations (Box 3.2).

Box 3.2 The Political Economy of Privatization in Transitional South Africa 1980s-1994

South Africa's economic boom of the 1960s and early 1970s had been driven by its giant parastatals, such as the Iron and Steel Corporation (Iskor) and the state electricity utility company, Eskom. The decade of economic decline that followed was blamed, among other factors, on the dearth of investment in the public sector. Nonetheless, starting with the 1987 *White Paper on Privatization and Deregulation in the Republic of South Africa*, the National Party (NP) government initiated a policy of wide-ranging privatization. Iskor was privatized in 1989, National Sorghum in 1991, and others were to follow. Although the privatization process was framed in the language of economic efficiency, it was actually grounded in the NP's exit strategy, and in the sectoral competition within transitional South Africa's political economy.

Between 1948 when the NP came to power, and its abdication in the early 1990s, it brought approximately 57 percent of the economy's fixed assets under state ownership. Before Black South Africa became the threat, English-speakers provided the major competition to Afrikaner interests, and the antecedent to using a captured state to promote these interests was the earlier Afrikaner use of political power to erode British economic power. By the beginning of the 1880s, the mining industry had slipped into British hands, and to balance their growing influence the president of the Transvaal Republic, Paul Kruger, used his political position to grant monopolistic concessions to his Afrikaner supporters. Thus the British-owned mines had to deal with state granted monopolies for necessary supplies, such as explosives, railways, food and timber. The parastatals created in the latter half of the 1900s under apartheid rule echoed Kruger's concessions of a half century earlier.

Privatizations in South Africa were not driven by fiscal and inefficiency concerns. By the late 1980s, South Africa's external debt had actually declined and although inflation rose dramatically up to 1975, it remained under control thereafter. Similarly, South Africa's budget deficit did not become severe until 1992/93, after the privatization policy had already been established. The introduction of competition was not a main driver either as the structure of South Africa's economy exposed newly privatized enterprises to little threat of market entry by

⁶² The union leader, Francisco Hernández Juárez, was a supporter of privatization and a close ally of Salinas.

new competitors. The timing and context of privatizations points to political rather than economic logic as the catalyst. The first major privatization venture occurred in late 1989 through a sale and stock exchange listing of Iscor, just months before Nelson Mandela was freed from jail. Indeed, the privatization policy promoted by the NP government during South Africa's transition was embedded in a larger transformation within South Africa's political economy. South Africa's state enterprises were created for overtly political reasons and, privatization was another tool through which the government attempted to achieve the same objectives as motivated the original creation of the public sector. The NP's privatization program was triggered by the prospect of losing control of the state; it was meant to prevent its opponents, the "democratic movement," and particularly the ANC, from inheriting the vast resources controlled by South Africa's state enterprises. Thus, privatization was part of the NP's attempt to manage South Africa's transition so as to limit the power of the ANC. First, this meant a less intrusive state; a state that the NP would no longer dominate. Second, the advantages accumulated during decades of apartheid rule meant that a "free market" would promote the interests of the same groups that had benefited from apartheid and were the only ones with enough economic power to purchase the privatized companies (Hentz 2000).

Winners of the Economic Liberalization

3.26 We have so far argued that one of the major sources of the weak growth performance of the Mexican economy is lack of competitiveness and that this is due in no small measure to the concentrated structures in key sectors. Furthermore, we have argued that in several key moments when government policies could have turned the structures of these sectors more open and thus competitive, the government's choice has tended to be to favor market concentration. As in any major economic reform, privatization entails winners and losers. While it is not appropriate to characterize the entire privatization program on the basis of a few cases, the emerging pattern from those cases examined seems to be one where winners are the small number of large, well-established economic elites, while the losers are the general consumers that have to absorb higher prices and smaller firms that suffer from higher input costs than would have prevailed had the privatization process been less friendly to members of the Mexican economic elite.

3.27 For example, the Mexican elite has benefited from restrictions on foreign entry into privatized sectors. In a number of Latin American countries, privatization has been associated with the entry of foreign capital.⁶³ In Mexico, in contrast, among the large-scale privatizations listed in Table 3.4, only a few were acquired solely by foreign investors.⁶⁴ Only five privatizations were carried out with the participation of foreign

⁶³ This itself has generated much criticism as in Argentina's airline industry.

⁶⁴ An Indian company (Grupo Caribbean Ispat) acquired a portion of Siderúrgica Lázaro plants, Unilever (UK, Holland) acquired a portion of UNASUPO plants, an Australian company (Kelpie Industries de México) acquired one subsidiary of grupo DINA, a Canadian company (Bombardier) acquired Ferrocarriles, two Japanese companies (Kyowa Hakko Kogyo Co. and Sumitomo Corp.) which were already minority shareholders before privatization acquired Fermentaciones Mexicanas, and an American company (Grupo Sonoco de México) acquired Manufacturas cargo.

investors. The majority of subscribed capital across the privatization program was therefore provided by Mexican investors. Thus, the importance of foreign investment in the acquisition of Mexico's public enterprises has been limited because of the restrictions on foreign capital participation.

3.28 Another striking pattern that emerges from Table 3.4 is the active role of the "newly rising" entrepreneurs. These are entrepreneurs and enterprises that emerged during the restructuring of the private sector in the 1980s through the bank nationalization and the securities boom. Some of their positions were further solidified through their active participation in these large-scale privatization deals (and in some cases at least, the government protection that the deals themselves offered after the acquisition of the assets) (Hoshino 1996). Therefore, as some have argued (e.g., Wise 2003), these privatization episodes marked a new turn in the government/PRI-business relations in Mexico, and the formation of the so-called neoliberal coalition that also supported the government's other economic reform measures, most notably the free trade initiative.

3.29 Both the historical pattern of industrial development and the more recent evolution have led to a concentrated structure within many major sectors of the economy. In addition, within each firm or a business group, control over the assets and management tends to be in the hands of the leading families that run the conglomerate. Most family businesses in Mexico were established after the Second World War, during the import substitution industrialization period and many of the more recent arrivals are also run essentially as family-owned firms. As family businesses, large shares as well as positions on the board and management are concentrated in the hands of the owner families and the positions of family members. In most firms, "shares with voting rights are concentrated in the owner family in a proportion that easily surpasses 50%" (Hoshino 2004, p.11).

Table 3.4 Acquisition of Large-scale State-owned Enterprises, Mexico 1988-92

	Carried out by leading enterprises and entrepreneurs ⁶⁵	Carried out by newly rising entrepreneurs and enterprises ⁶⁶
Non-bank deals	<ol style="list-style-type: none"> 1. Mexicana de Cobre/Mexicana de Acido Sulfúrico 2. Fertilizantes Mexicanos & co. 3. Ingenios & co. 4. Tereftalatos Mexicanos, 5. Petróleos Mexicanos & co. (some subsidiaries), 6. Rassini Rheen, 7. Red Nacional de Televisión & co. 8. <i>Siderúrgica Lázaro Cárdenas,</i> 9. <i>Altos Hornos de México,</i> 10. <i>Consortio Minero B.J.,</i> 	<ol style="list-style-type: none"> 1. Aseguradora Mexicana & Hidalgo, 2. Ingenios (a portion of the plants), 3. Minera Real de Angeles & co., 4. Productos Pesqueros de Sinaloa & co., 5. Tabacos Mexicanos (a portion of the plants), 6. Cía Minera Autlán 7. Alimentos Balanceados de México (a portion of the plants), 8. Teléfonos de México, 9. <i>CONASUPO & co,</i> 10. Aeronaves de México, 11. Tubacero, 12. Mexicana de Aviación, 13. <i>Merinox</i> 14. <i>Grupo DINA & co.</i> 15. Hoteles El Presidente
Bank deals	<ol style="list-style-type: none"> 1. Bancomer, 2. Banca Serfin, 3. Multibanco Comermex, 4. Banco 5. Banoro 	<ol style="list-style-type: none"> 1. Banco Nacional de México, 2. Banca Mexicana Somex, 3. Banco Mercantil del Norte, 4. Banco del Atlántico, 5. Banca Promex, 6. Banca Confía, 7. Banca B.C.H, 8. Banco del Centro, 9. Banca Cremi, 10. Multibanco Mercantil de México, 11. Banpaís, 12. Banco de Crédito y Servicio, 13. Banco de Oriente

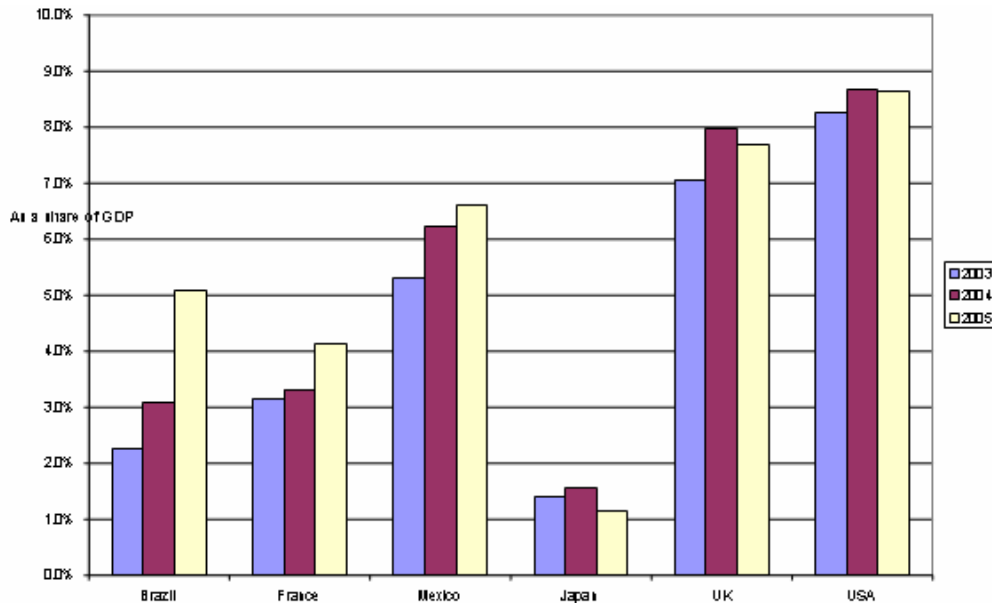
Source: Hoshino (1996). In *italics*, companies acquired with participation of foreign investors. Companies acquired only by foreigners are: Const. Nac. de Carros y Ferrocarriles, Fermentaciones Mexicanas y Manufacturas Cargo.

⁶⁵ The entities involved in the acquisition represent Mexico's preeminent domestic business groups. From 7 to 10 of the acquisitions were carried out by leading enterprises and entrepreneurs in alliance with others. The founding family of the discount shop chain Elekrika obtained assistance from the Saba family in the acquisition of number 7. Villacero formed an alliance with other entrepreneurs involved in the iron and steel industry and with foreign-owned enterprises in the acquisition of number 8. The Autrey family, founding family of the pharmaceutical company, Casa Autrey, formed a consortium with domestic and foreign-owned enterprises in the iron and steel industry to acquire 9 and 10. 7, 9 and 10 were acquisitions that took the purchasing entities into new fields of business.

⁶⁶ Cases where the acquiring entity was set up specifically for the privatization. The acquisition of banks under this category was undertaken mostly by groups led by new entrepreneurs who arose from the securities business.

3.30 A result is a striking concentration of wealth, especially at the top of the income distribution. Mexico is already highly unequal by international standards when measured in the standard fashion: in 2000 the incomes of the top ten percent of the population were 45 times that of the bottom ten percent, according to the national income and expenditure survey (ENIGH). The Gini coefficient was 54.6, showing inequality slightly lower than in Brazil, Bolivia, Colombia and Chile (De Ferranti et al. 2004). However, these measures understate the extent of income concentration, since they are not designed to account for assets of the wealthiest of the wealthy. Forbes publishes data showing that Mexican billionaires hold a larger share of GDP than in Brazil, a share that has increased in both countries in the last few years (Figure 3.3). In 2005, billionaire wealth in Mexico was 6.5 percent of GDP, similar to the US and UK, higher than in France and Japan (whose average incomes are much higher).

Figure 3.3 Net worth of Local Billionaires in Relation to GDP (Mexico and other countries)



Source: www.forbes.com.

3.31 By itself, high concentration of income is not necessarily detrimental to growth. The impact of unequal income and wealth on growth depends on whether it is the result of dynamic, wealth-creating individuals or of rent-seeking entrepreneurs with high levels of influence. International evidence finds self-made billionaire wealth to be associated with higher growth, but inherited billionaire wealth to be associated with lower growth (Morck, Wolfenzon and Yeung 2004). Although Mexican billionaires in general did not inherit their wealth, they gained it through political connections and privileged access to markets rather than through the innovation and competitive effort that are associated with growth. Moreover, some forms of wealth concentration are associated with extensive control that distorts market functioning and policy-making. As Morck, Wolfenzon and Yeung (2004, p.3) argue:

“Entrusting the governance of huge slices of a country’s corporate sector to a tiny collection of elites can bias capital allocation to advantage those elites, and can also reduce the pace of innovation... In addition, to preserve their privileged positions under the *status quo*, the controlling elites arguably use political connections to stymie the institutional development of capital markets and to erect a variety of entry barriers.”

3.32 As documented in Guerrero, Lopez-Calva and Walton (2006), this pattern of wealth concentration hampers economic competitiveness and growth. In general, where oligarchic family control of economic activities is high, growth is lower, health status worse, the quality of government worse and income inequality higher.⁶⁷ In Mexico, as well, evidence suggests that control rights of firms lead to private benefits in excess of the value to non-controlling shareholders. The premium of block and voting purchases (that confer control rights) reaches 34 and 36 percent, respectively, in Mexico compared to the market value (that reflects the value to non-controlling shareholders). These are higher than the corresponding figures for the US (2 percent and 2 percent), South Korea (16 percent and 29 percent) and Chile (15 percent and 23 percent), although comparable to Italy (37 percent and 29 percent) and Brazil (65 percent and 23 percent). In addition, the concentration of wealth exacerbates the role of money in politics and drives a wedge between voters and politicians in ways that limit the effects of electoral accountability.

Political Effects of Trade Liberalization

3.33 The pattern of economic liberalization accentuating wealth concentration was repeated in the case of trade liberalization through the North America Free Trade Agreement (NAFTA). Again, it was the large, internationally-oriented firms that had privileged access to government decision-making during the trade negotiation process. These large firms actively participated in the negotiation process as virtually equal partners of the government representatives through a special committee (*Coordinadora de Organismos Empresariales de Comercio Exterior*, COECE) created to represent the peak association of large businesses (*Consejo Coordinador Empresarial*, CCE). By one account, the government not only solicited COECE’s comments on its draft NAFTA agreement, but accepted 90 percent of its comments in an approximately 50-page document (Thacker 1999).

3.34 In contrast, small and medium-sized firms which had traditionally been represented through its peak organization CANACINTRA as part of the PRI’s corporatist structure were largely left out of the bilateral negotiation process. In the old corporatist arrangement, these firms were given a degree of protection, especially under the import-substitution-industrialization strategy of the earlier days, in exchange for support for the regime. Thus, CANACINTRA, in many ways, was as much a

⁶⁷ These results should be treated as *only* suggestive, since they face the standard problems of potential omitted variables and endogeneity of cross-country regressions.

mechanism for government control of the domestic business sector as a genuine forum for representing business interests. In the NAFTA negotiation, CANACINTRA was outperformed by COECE which enjoyed far superior financial and human resources to devote to the trade negotiations. Furthermore, the greater heterogeneity of interests among the CANACINTRA members made it far more difficult for its leaders to represent the entire sector before the government (Shadlen 1998).

3.35 The virtual exclusion of the small and medium-sized firms from the NAFTA negotiation process signified a shift in the coalition behind the PRI-led economic reforms, as Mexico switched from an import-substitution industrialization strategy to a market-friendly, open economy model. This political shift did not necessarily mean that these firms incurred economic costs of the trade liberalization. Some probably have, but the overall economic benefits of the trade liberalization have been positive (Box 3.3). Besides, to the extent the liberalization measures closed off channels of state protection and rent sharing, effects on democratic governance *Encuesta Nacional de Vivienda*, Parametría, November 2006 are also expected to be positive.

Box 3.3 Impact of NAFTA

Economic effects of NAFTA and trade liberalization in general have been a subject of heated debates. As a contribution to this debate, Lederman et al. (2003) conducted a careful evaluation of selected aspects of NAFTA's economic impacts. Because Mexico has experienced several major economic shocks since the early 1990s, including the Tequila crisis in the mid 1990s and the contagion effects of the financial crises in Asia, Russia and South America in the late 1990s, it is difficult to isolate the impact of NAFTA on the Mexican economy. Nevertheless, the analysis indicates that the trade liberalization has had positive effects on trade, foreign direct investments and income per capita in Mexico. The study also finds that NAFTA's benefits have been shared unevenly between the northern and the southern regions of Mexico, even though this regional divide was in no way caused by NAFTA. It should also be noted, however, that the "inequality" of NAFTA's benefits is relative – poorer states benefited from NAFTA in absolute terms, but richer states have tended to grow faster since 1993.

Some of the unequal effects of NAFTA include: i) the rise in the wages of those with higher levels of education, relative to those with less; ii) faster growth in Northern and Central states throughout the 1990s and slower growth of the poorer Southern states due to low levels of education, infrastructure and quality of local institutions; iii) increased access of large Mexican firms to northern capital markets as domestic credit dried up after the Tequila crisis, while credit remained constrained for small and medium-sized enterprises; and iv) increased productivity of the irrigated lands in contrast to domestically-oriented, non-irrigated agriculture.

The study concludes that NAFTA has brought about net gains to Mexico, but its effects have been dampened by some of the Mexican economy's limitations such as the relatively deficient education system and lack of investment in technological innovations. Similarly, certain institutional weaknesses such as the weak rule of law and the relatively high level of corruption have prevented Mexico from taking full advantage of the trade liberalization as well.

3.36 One economic consequence of NAFTA, whether real or merely perceived, that is expected to have effects on the evolution of democratic governance in Mexico is its effects on inequality among regions within the country. As the Bank's analysis finds, the more developed and competitive regions and sectors have taken greater advantage of NAFTA than the lagging regions of the south. This is consistent with the study's overall finding that certain pre-conditions such as better systems of education and technological innovations and high quality institutions such as the strong rule of law mediate NAFTA's economic effects. Poorer states tend to be less well-endowed with these pre-conditions than richer ones. It is also consistent with the finding of a study (Hiskey 2005) that states with more credible political institutions have recovered more quickly from the economic crisis in the mid 1990s. This phenomenon, even though it has brought about net benefits to both the more and the less developed regions, may have contributed to worsening the sense of political polarization.

SUMMARY

3.37 Following Chapter 2 which documented the role of special interests as obstacles to deepening social policies in Mexico, Chapter 3 has described a similar picture with respect to Mexico's economic elites. Certain economic elites had gained uniquely advantageous positions during the decades of privileged access to power and government protection. While the economic liberalization measures, which removed some of the explicit government rents, may have contributed to less collusive government-business relations, anecdotes from specific instances of privatization and trade liberalization reforms suggest that strong business influence on politics continues, albeit with some changes in the identities of the elites involved and the form of the interactions between the state and businesses. The clear tendency of wealth concentration and unequal distribution of economic benefits (and of the corresponding political influence) has created a highly unequal political playing field where a small number of well-endowed and well-connected business elites manage to obtain preferential concessions from the government (typically in the form of market protection).

3.38 We have no direct evidence of how these economic agents influence politics outside these policy episodes that affect their interests directly. But the extraordinary level of wealth concentration in an economy where the state's hands are still fairly visible may be a cause of concern for the country's incipient democratic consolidation.

3.39 A flip side of the high concentration of wealth and power among a small number of economic elites is the perception of inequality among the less privileged segments of society. Combined with the uneven distribution of the benefits of economic opening since the early 1990s, such a perception of inequality appears to have exacerbated the political polarization (even if actual inequality seems to have stayed constant). As we will argue in the final chapter, polarization and a sense of relative deprivation can limit beneficial effects of electoral accountability by weakening the credibility of the politicians who represent "the other side" of the divide from the point of view of an individual voter, and thus limit the potential of democratic governance in Mexico.

4. POLITICAL OPENING, DIVIDED GOVERNMENT, AND ECONOMIC REFORMS

4.1 Chapter 2 showed that increased competitiveness in democratic elections is changing political incentives and making politicians and governments increasingly responsive to demands and needs of the majority of Mexicans. However, the chapter also argued that the pressures of electoral accountability have not been accompanied by corresponding reduction in the influence of strong vested interests. In fact, Chapter 3 presented evidence that the concentration of wealth has increased since the early 1990s and with it, probably, the economic and political influence of the wealthy.

4.2 One possible reason for the continued influence of vested interests is the fragmentation of political authority in Mexico. The ongoing democratic opening in Mexico has diffused political power among a variety of actors, including sub-national governments and the judiciary, to name a few (Lehoucq et al. 2005). In Mexico, the perception is that the divided governments in place since 1997 have led to “gridlock,” or paralysis of needed economic reforms, for at least two reasons.⁶⁸ On the one hand, divided governments force the ruling political party to obtain legislative support from one or more opposition parties.⁶⁹ On the other, when authority is more fragmented, vested interests may be able to block reform more easily by gaining access to a minority of decision-makers who occupy key positions in the policy-making process.

4.3 In this chapter, we focus our attention on one aspect of power diffusion, that is, the extent to which the demise of the single-party hegemony in Mexico and the advent of divided government are responsible for the lack of significant reform progress since 2000. We address this issue in two ways, asking first whether the lack of reform progress can be attributed to the mere existence of divided government. Our answer here is largely negative. Second, however, we ask whether institutional reforms that are frequently advanced in Mexico to resolve problems of gridlock might have other effects on reform, by changing the incentives of political actors. Here, we find weak evidence that some institutional reforms might accelerate reforms in some areas of policy concern. One reason for the weak connection between institutional reforms and policy outcomes is explored in Chapter 5: distortions in the underlying dynamics of political competition in Mexico.

⁶⁸ A fuller treatment of power diffusion should include analyses of the effects of decentralization on national governance as well as the roles of other institutional actors at the national level such as the judiciary. Those topics are covered in Lehoucq et al (2005).

⁶⁹ Divided government is where the executive and the legislative branches are controlled by different political parties.

MEXICO'S REFORM PERFORMANCE

4.4 For most of the 70-year period under PRI dominance, the presidency enjoyed uncontested authority over the Congress which was also dominated by the PRI. With the gradual decline in the PRI's hold over the Congress,⁷⁰ the president's ability to influence legislative outcomes also diminished. With the defeat of the PRI in 2000, this arrangement that gave the presidents "meta constitutional" powers to influence legislative and other political decisions also disappeared. As summarized by a Mexican political scientist (Rubio 2004, p. 24):

"Political power has migrated away from the presidency to, first and foremost, the Congress. The Congress has become the center for political negotiations, as well as a major source of gridlock. Since the members of the Congress cannot run for consecutive terms, they have little or no incentive to negotiate with the president or listen to their constituents."

4.5 The new reality left the Mexican state with a president whose formal constitutional powers are more limited than in many other presidential systems, and with a divided government. Table 4.1 presents a cross-country comparison in terms of the president's power to present legislative initiatives to Congress. As shown in the table, Mexican presidents cannot limit the ability of Congress to introduce amendments or changes to their proposed legislation, and Congress is not obliged to respond within a certain time period. In contrast, other Latin American presidents have the "fast-track" option, by which Congress can only approve or reject their initiatives without introducing any changes and when Congress does not act on the president's legislative initiative within a certain time period, the initiative is automatically approved.

⁷⁰ In 1988, the PRI's share in the Congress dropped to below the two thirds of the seats that were necessary to pass constitutional amendments, and in 1997, the PRI lost a majority of the Congressional seats.

Table 4.1 Executive's Ability to Introduce Legislative Initiatives

Country	Year	Presidential Initiative		
		Exclusive	Urgency	Decrees
Argentina	1994	No	No	Yes
Brasil	1999	Yes	Yes	Yes
Chile	1997	Yes	Yes	Yes
Colombia	1997	Yes	No	Yes
Mexico	1996	No	No	No
Peru	1993	No	Yes	Yes
Uruguay	1997	Yes	Yes	No

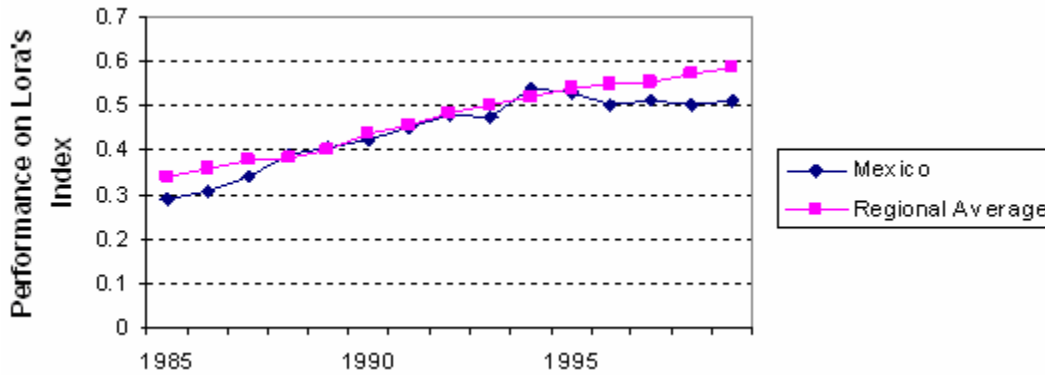
Source: Colomer and Negretto (2003).

4.6 It is hardly contestable that PRI presidents' "meta constitutional" powers facilitated adoption of some reforms such as those implemented during the Salinas *sexenio*. What is not obvious is whether somehow reviving a similar arrangement – if it were possible at all – would be a solution for the evident slow-down in the pace of economic reforms in Mexico. In fact, our analysis indicates that the issue is more nuanced than a simple notion of a divided government causing reform paralysis because of institutional gridlock.

4.7 In the first place, apart from the flurry of reforms during the Salinas *sexenio* (1988-94), Mexico was in fact not an aggressive reformer prior to the 2000 elections. One signal of this is Mexico's rank on Eduardo Lora's Structural Reform Index, which measures progress in trade and financial services liberalization, tax reform, privatization, and labor reform between 1985 and 1999 (Lora 2001). Figure 4.1 shows that for most of the period, Mexico was at or below the Latin American regional average. Only during the Salinas administration did Mexico more aggressively reform its economy. Even here, as Chapter 3 demonstrates, reforms did not always result in a more competitive economic structure or in an equitable distribution of economic benefits.⁷¹

⁷¹ But even then, as we saw in Chapter 3, some of the reforms led to a mere ownership change of monopolies but did little to modify the regulatory framework.

Figure 4.1 Structural Reform Progress, 1985-99



Source: Lora (2001).

4.8 How does the earlier period compare with legislative productivity since 2000? The comparison hinges on whether one considers constitutional reforms or ordinary legislation. The number of *constitutional* reforms introduced and approved has markedly decelerated since the advent of divided government in 1997. As of May 2006, the number of constitutional reforms passed during the last three *sexenios* declined from 52 and 76 in the Salinas and Zedillo administrations, respectively, to 23 in the Fox administration (see Table 4.1). Furthermore, the average length of days it took the reforms to be approved in the Chamber has been much longer in the Fox administration (more than 550 days) compared to the two previous administrations (between 83 and 186 days).

Table 4.2 Constitutional Reforms by Legislative Period, 1988 – 2006

Legislative Period	President	No. of Arts. Reformed/1	Avg. duration/2	Avg vote/3	% avg/4
1988-91 (54)	Salinas I	10	178	315.6	63%
1991-94 (55)	Salinas II	42	83	325.9	66%
1994-97 (56)	Zedillo I	54	124	396.6	79%
1997-00 (57)	Zedillo II	22	186	380.6	76%
2000-03 (58)	Fox I	13	565	399.8	80%
2003-06 (59)	Fox II	2	552	393.0	79%
		143	281	368.2	74%

1. Does not include transitory articles.

2. Average calendar days between the date of initial submission and publication in *Diario Oficial de la Federación*.

3. Requires two-thirds of the Lower House (500x2/3=334).

4. Percentage does not take into account quorum in each session.

Source: *Gaceta Parlamentaria*, and <http://www.diputados.gob.mx/leyinfo/refcns/index.htm>.

4.9 Looking to the period before 1997, constitutional reforms were quite frequent in Mexico. Between the promulgation of the Constitution in 1917 and September 2004, there were 416 constitutional reforms (4.7 per year, 29.7 per *sexenio*, compared to 52

constitutional reforms between 1988 and 2006, or 2.9 per year in Brazil),⁷² but a sizable share of these (187) took place over the 1982-2000 period during the three *sexenios* of de la Madrid, Salinas, and Zedillo (10.4 per year, 62.3 per *sexenio*). This is consistent with the notion that these three PRI presidents aggressively pushed reforms.⁷³

4.10 Table 4.3 summarizes the content of the constitutional reforms passed during the last three presidential administrations. Most of the economic reforms touted as the main achievements of the Salinas administration (e.g., NAFTA, privatizations), except the re-privatization of the banks that had been nationalized in the early 1980s, happened in the second half of the *sexenio*. Salinas was elected in 1988 in a highly contested election amid accusations of systematic fraud. At the same time, the PRI lost the two-thirds “super majority” in Congress it had always held. The PRI, however, regained its presence in Congress at the 1991 mid-term elections, and with this victory, Salinas strengthened his political bargaining power. Given this specific circumstance, the observed pattern of reform passage – more reforms in the second half of the term – is consistent with the gridlock hypothesis that the ease of reforms depends on the extent to which the party in power controls the Congress.

4.11 However, the pattern becomes less obvious in the Zedillo administration. By the same logic, we would expect far more reforms in the first half of the Zedillo presidency, when the PRI still maintained a simple majority in Congress (60% of the seats) than in the second half, when the opposition outnumbered the PRI for the first time. This is the case if we use as the unit of analysis the number of constitutional articles modified. But if we count the number of issues addressed, the second half of the Zedillo administration “out-performs” the first half, in spite of not controlling the simple majority, let alone the two-thirds super majority.

⁷² It is not surprising that Brazil has had many constitutional reforms because its broad coverage and details increase the scope and the need for constitutional reforms for major policy changes.

⁷³ Interestingly, some of the reforms in the Salinas presidency were passed without the required two-thirds of the votes of the full Lower House (as reflected in the average of 63% and 66%). This was because the PRD frequently boycotted the voting sessions in protest against the government – Salinas won the presidential election in 1988 against the PRD candidate Cuauhtémoc Cárdenas amid accusations of massive fraud. The absence of the PRD reduced the quorum and permitted the PRI and the PAN to obtain more than two-thirds of those present to pass these reforms.

Table 4.3 Constitutional Reforms by Presidential Administration, 1988-06

Date/1	Reformed Articles/2	Concept
Carlos Salinas, 1988-1994		
06/04/1990	5, 35, 36, 41, 54, 60, 73	Electoral Reform
27/06/1990	28, 123	Banking Privatization
06/01/1992	27	<i>Ejido</i> Property
28/01/1992	3, 4, 5, 24, 27, 102, 130	State-Church Relations / Human Rights
05/03/1993	3, 31	Secondary Education
20/08/1993	28, 73, 82, 123	Central Bank's Autonomy
03/09/1993	16, 19, 20, 41, 54, 56, 60, 63, 65, 66, 74, 100, 107, 119	Increase of Senate seats / Electoral Reform
25/10/1993	31, 44, 73, 74, 76, 79, 89, 104, 105, 107, 119, 122	Mexico City's Local Congress / Judicial Branch
19/04/1994	41	Electoral reform
1/07/1994	82	Requisites for becoming President
Ernesto Zedillo, 1994-2000		
31/12/1994	21, 55, 73, 76, 79, 89, 93, 94, 95, 96, 97, 98, 99, 100, 101, 102, 103, 104, 105, 106, 107, 108, 110, 111, 116, 122	Judicial Reform
03/03/1995	28	Communications and Railroads Liberalization
03/07/1996	16, 20, 21, 22, 73	Penal Reform
22/08/1996	35, 36, 41, 54, 56, 60, 73, 74, 94, 98, 99, 101, 105, 108, 110, 111, 116, 122	Electoral Reform (IFE Autonomy)
20/03/1997	30, 32, 37	Mexican Citizenship
08/03/1999	16, 19, 22, 123	Public Security
11/06/1999	94, 97, 100, 107	Judicial Branch Reform
28/06/1999	4, 25, 73	Environment / Sports / Civil Defense
29/07/1999	58	Minimum Age for Deputies
30/07/1999	73, 74, 78, 79	Federal Auditor General
13/09/1999	102	Human Rights Commission Functions
23/12/1999	115	Municipalities' competencies
07/04/2000	4	Children Rights
21/09/2000	20, 73	Victims' Rights / Congressional competencies
Vicente Fox, 2000-2006/3		
14/08/2001	1, 2, 4, 18, 115	Indigenous Peoples' Rights
14/06/2002	113	Compensation for damages by the State
12/11/2002	3, 31	Pre-Elementary and Higher Education
29/10/2003	63, 77	Vacancies and Extra-ordinary Elections
05/04/2004	73, 89	National Security
30/07/2004	74	Calendar for the Expenditures Budget
02/08/2004	65	Expansion of the Legislative Period
27/09/2004	73	Fishing and Aquaculture
20/06/2005	21	Recognition of the International Criminal Court
28/11/2005	73	State/Municipal courts' jurisprudence crimes
8/12/2005	46, 73, 76, 105	State geographical limits
9/12/2005	14, 22	Prohibition of Capital Punishment
12/12/2005	18	Under-aged crimes
7/4/2006	26, 73	National Planning System
14/09/2006	105	Human Rights

1. Date published on the *Diario Oficial de la Federación*.

2. Transitory articles and errata not included.

3. Up to September 14, 2006.

Source: *Cámara de Diputados* (<http://www.diputados.gob.mx/leyinfo/refcns/>).

4.12 The picture gets more subtle and complex once we turn our attention to legislative processes more broadly. First, the rate of introducing new ordinary legislation did not decline during the Fox administration. On the contrary, the number

of initiatives discussed in Congress went from 250 for the 1991-97 period and 600 for the 1997-2000 period, to more than 1,200 for the 2000-03 period. Unlike in the heyday of the PRI hegemony, much of this legislative “productivity” is due to the increased activism of the political parties as initiators of legislative proposals (Table 4.4). Thus, in 1991-97, with PRI still in control of the majority in both houses of Congress, the Executive introduced 208 initiatives to various congressional commissions and had 205 of them approved (an astounding 98.5% “success” rate). In contrast, the political parties (including PRI) introduced 286 initiatives and had only 52 of them approved (less than 20% “success” rate). Between 1997 and 2003, under divided government, the number of Executive proposals dropped to 93, though they still showed a respectable “success” rate of about 84% (i.e., 78 initiatives approved). In contrast, the number of initiatives by the political parties skyrocketed to 1,720 in this period, which resulted in 334 of them approved.

4.13 Thus the “success” rate remained low, but in terms of the final outcome of the number of initiatives approved, the “hyper-activity” more than compensated for the low “success” rate (Aparicio 2005). This pattern implies that before the advent of divided government, the PRI exercised tight control of legislative agenda, proposed only those bills that had a near guarantee of eventual passage, and negotiated the content of these bills largely prior to their submission to the formal legislative process (i.e., negotiations “behind closed doors”).

Table 4.4 “Productivity” of the Federal Lower House, 1991 – 2006

Initiator	Laws approved/Bills introduced				
	1991-94	1994-97	1997-00	2000-03	2003-06
Executive	122/124	83/84	28/32	50/61	16/32
PRI	11/30	7/19	15/86	54/306	114/749
PAN	4/26	8/79	31/168	65/265	56/368
PRD	2/32	3/45	30/157	45/294	37/320
Others*	10/31	7/24	43/163	61/281	56/504
Total	149/243	108/251	137/606	275/1207	279/1973

*Includes initiatives from other parties, independents, joint, and state legislatures.

Source: *Sistema Integral de Información y Difusión de la Cámara de Diputados*.

4.14 Table 4.5 shows the frequency of federal law reforms during the last three presidential administrations. Of the 244 federal laws currently in force, 88 have never been modified since their promulgation. Of the remaining 156 laws, 96 were added as new during this period. The other 60 laws were reformed multiple times (792 times altogether, or 13.2 modifications per law). The figures show that during the Fox administration, there were even more reforms of the existing federal laws and enactment of new ones than the Zedillo or the Salinas administration. Not only the Fox administration but also the Zedillo administration, whose government was divided in

the second half of its term, managed to pass more new federal laws and obtain legislative approvals for federal law reforms than the Salinas administration. Of course, these tallies do not give us any information regarding relative importance of these bills and the political difficulties in passing them. Nor do they negate the fact that the major structural reforms that the government itself targeted as priorities failed to pass. Nonetheless, this observed level of legislative productivity is inconsistent with the claim that divided government is paralyzing policy-making in Mexico.

Table 4.5 Reforms to Federal Laws by Administration, 1988 – 2006

	1988-2005	Salinas	Zedillo	Fox *
Reforms to Federal Laws	792	180	263	349
New Laws	96	17	38	41

Source: "*Sumario de Reformas a las Leyes Federales Vigentes*", *Cámara de Diputados*, June 1, 2006.

4.15 Table 4.6 reports data on the distribution of some legislative reforms by content during the last three administrations. Again, these data are not perfect substitutes for a detailed, qualitative review of each of the reform content, but serve as an illustration of a likely pattern over time. The upper portion of the table shows the number of reforms to some of the major federal laws during this period. Of the federal laws, those that have gone through the most frequent modifications included those governing fiscal and taxation matters and criminal justice (Aparicio 2005). In these areas, the “performance” of the three administrations is more or less comparable, although the reforms to the General Health Law is included as an illustration of a case in which there were more legislative activities during the Fox administration than its predecessors.

4.16 In contrast, the federal laws governing the four contentious areas of structural reforms – energy/petroleum, pension, and labor (see the bottom portion of Table 4.6) – together have gone through far fewer changes in the same period, although in this case the Zedillo administration enacted more legislative modifications than either the Fox administration, or the Salinas administration, the best known of the three for pursuing aggressive economic reforms. Again, these tallies should be interpreted with caution. They offer no insight into the quality and the relative significance of each of the legal changes. Nonetheless, they do generally support the contention that these policy areas have always defied reform attempts even during the height of the reformist presidencies.

4.17 In sum, while the Fox administration’s failure to pass the currently pending energy, labor and public sector pension reforms has indeed been disappointing, it appears that the sources of these reform failures are not necessarily institutional (i.e., not simply because of the presence of divided government). In fact, the inability to have

these particular reforms enacted is not unique to the current administration. No previous administration, even at the height of PRI hegemony, was able to make significant headway with them, either. The vested interests that have blocked reform since 2000 seem to have been at least as influential, if not more, prior to 2000.

Table 4.6 Reforms to Selected Federal Laws, 1988 – 2006

Laws with frequent reforms				
Sector	Law	Salinas	Zedillo	Fox
Criminal Justice	CÓDIGO PENAL FEDERAL	13	13	13
	CÓDIGO FEDERAL DE PROCEDIMIENTOS PENALES	8	9	9
Taxation*	LEY DEL IMPUESTO AL VALOR AGREGADO	7	8	12
	LEY DEL IMPUESTO ESPECIAL SOBRE PRODUCCIÓN Y SERVICIOS	6	8	7
	LEY DEL IMPUESTO SOBRE LA RENTA	-	-	11
Health	LEY GENERAL DE SALUD	1	3	22
	Total	35	41	74
Laws with limited reforms				
Energy	LEY DEL SERVICIO PÚBLICO DE ENERGÍA ELÉCTRICA	3	-	-
Petroleum	LEY REGLAMENTARIA DEL ART. 27 CONSTIT. EN EL RAMO DEL PETRÓLEO	-	2	2
Pensions	LEY DE LOS SISTEMAS DE AHORRO PARA EL RETIRO	-	4	4
Labor	LEY FEDERAL DE LOS TRABAJADORES AL SERVICIO DEL ESTADO, REGLAMENTARIA DEL APDO. B DEL ART. 123	-	1	1
	LEY FEDERAL DEL TRABAJO	-	1	1
	Total	3	8	8

Source: "Sumario de Reformas a las Leyes Federales Vigentes", Cámara de Diputados, Sep. 19, 2006.

* Selected tax laws for illustration only.

PETROLEUM REFORM: CASE STUDY

4.18 Causes of the reform failures are multiple, and the specific reasons vary from one case to another. To illustrate these multiple forces at play, we include a case study of the political economy of energy/petroleum reform.⁷⁴ A critical issue for the state petroleum company, Pemex, is to ensure sufficient oil reserves. The cost of exploration and development needed to ensure reserves beyond the currently estimated 10 – 15 years is judged to be in the range of US\$10 billion a year (Shields, 2005: 22, 36). Actual expenditures have fallen significantly below this because of transfers from Pemex to government finances. This situation has necessitated reforms to allow Pemex to retain more funds for its own investments, to seek additional sources of capital by encouraging greater private participation in downstream operations, and to strengthen corporate governance to ensure Pemex uses its funds efficiently. This section illustrates how vested interests have persistently blocked reform, both during the PRI era and before the diffusion of political authority, and subsequently.

4.19 It is well-known that the efficient use of capital is a significant problem for Pemex. Major sources of Pemex's operational inefficiency include the bloated staffing, 80% of whom belong to the union aligned with the PRI and extract generous salary and pension benefits (León and Rosado, 2005), and the corporate governance that invites politicization in its policy decisions. For example, labor contract rigidities prevent the corporation from relocating excess employees from one area of the country to another. Jobs are reportedly sold to union members or even willed to their offspring. The Pemex board consists of the Secretary of Finance as the chairman, six other departmental secretaries, and five representatives of the union. Pemex has been entirely transparent in the political influence it has wielded to protect these arrangements: the PRI routinely allots several legislative seats to Pemex union officials, including the head of the union. Congress, as part of its annual budget proceedings, sets Pemex policies, including the highly important estimate of the price of crude oil.⁷⁵

4.20 Since the mid-1980s, there have been at least 3 attempts to reform Pemex, all of which aimed to improve the company's efficiency or ability to continue generating revenue for the central state. First, the Salinas administration managed to change the corporation's organic law in July 1992. One of the main results of this reform was to break Pemex into four different companies: Pemex Exploration and Production, Pemex Refinery, Pemex Gas and Basic Petrochemicals, and Pemex Petrol Chemicals (Pemex also licenses gas stations in Mexico).⁷⁶ Second, during the first half of his administration, President Zedillo tried to privatize one of the four companies, Pemex Petrol Chemicals. But Zedillo never sent a bill to Congress because of opposition from within the PRI. The

⁷⁴ This section is extracted from Lehoucq (2006).

⁷⁵ Until 1984, the petroleum workers union controlled half of Pemex's investment budget (Salinas, 2000: 507).

⁷⁶ Before breaking up Pemex, the Salinas administration also captured and imprisoned the notorious leader of the Pemex union, Joaquín Hernández Galicia (known as "La Quina") in 1989.

third reform episode unfolded during the Fox *sexenio* and culminated in the reform to the royalties law that governed Pemex's tax obligations (*Ley Federal de Derechos*).

4.21 The Fox administration focused upon efforts to increase the efficiency of the four Pemex subsidiaries, make the state corporation more transparent and accountable, and increase funds for exploration and development. Administration spokesmen also called for increasing the role of the private sector in Pemex (Shields, 2005: 83-130), given that the private sector is allowed to compete for service and materials contracts in Pemex subsidiaries. Indeed, government proposals have been part of a much broader policy debate about what to do with Pemex, which shows that the absence of reform is not due to lack of attempts. Between 2000 and April 2006, elected officials presented more than 100 bills having to do with Pemex and petroleum-related laws.⁷⁷ Most deal with relatively minor administrative changes of the sale of gas and energy service and materials contracts. Others are more comprehensive reforms aiming to change Pemex's corporate organization or to reduce the weight of executive branch appointees and union representatives on the corporation's board of directors. There are also several bills either aiming to increase the amount of oil income Pemex can retain for needed investment and/or to empower the corporation to partner with the private sector to develop oil deposits. Between 2000 and 2006, the Fox administration itself proposed half a dozen bills on Pemex and oil-related matters.⁷⁸

4.22 Late 2005, Congress approved a new Royalties Law for Pemex (*Ley Federal de Derechos*). Presented in September 2004, the royalties' reform bill aimed to restructure how Pemex is taxed. Prior to the reform, Pemex turned over 61 percent of its *total revenues* to the federal government (León, 2005), a situation that led the corporation to register annual losses over the past several years. Taking advantage of high international oil prices, the Fox administration's bill recommended reducing the state corporation's overall tax burden so that Pemex could retain a larger share of its income. The bill proposed that Pemex should pay a higher percentage of its *net income* after making complex deductions for business expenses. The bill also contained a proposal to place independent experts on the Pemex board.

4.23 After a year-long debate, the Fox administration managed to obtain changes to Pemex's fiscal arrangement, but did not get any change in its corporate organization. As a result of this law, the state oil corporation will obtain approximately US\$ 2 billion for

⁷⁷ Lehoucq (2006), based on reviews of bills presented to amend the following laws in *Gaceta Parlamentaria* (<http://gaceta.diputados.gob.mx/base>) (as of May 22, 2006): Ley Federal de Derechos, Ley de la Comisión Reguladora de Energía, Ley Orgánica de Petróleos Mexicanos y Organismos Subsidiarios, and the Ley Reglamentaria del artículo 27 Constitucional, en el Ramo de Petróleo.

⁷⁸ These mostly came in the second half of the presidential term. Some analysts suggest that the delay in presenting Pemex-related bills was a result of the executive concentrating his legislative energies on other matters like tax reform (e.g., León and Rosado 2005). Others argue that the Fox administration did not begin to address Pemex reform because it became embroiled in an ideological debate pitting privatization advocates against proponents of state control of Pemex (and state electrical companies) (e.g., Shields 2005).

its use, an amount that will gradually increase in following years. This figure represents 20 percent of the estimated amount of an appropriated investment budget and 5 percent of the estimated value of oil exports in 2006.⁷⁹ Parallel to these efforts, the executive and Congress passed a new Law of Budget and Financial Responsibility in early 2006 that, among other things, allocated a portion of extraordinary oil revenues (e.g., the estimated price of a barrel of crude exports that the executive proposes and the legislature approves) to a stabilization funds benefiting states (25 percent), infrastructure investments (25 percent), oil income (40 percent), and programs and projects for state-level infrastructure and equipment (10 percent). No progress was made in increasing private participation in the oil business or otherwise significantly improving Pemex's operational capacities.

4.24 This overall lack of progress on reforming Pemex appears to be due to multiple factors including (i) the role of vested interests in blocking reform attempts; and (ii) lukewarm support or even antagonism among the public. The union has no interest in increasing transparency and corporate accountability, outcomes that would reduce its privileges. Opening up the energy sector to private sector investment or the allocation of Pemex jobs on the basis of competitive merit would reduce the rents that the union has secured for itself. That the PRI typically grants union leaders candidate slots in the Chamber of Deputies or the Senate, where they can oversee policymaking in their areas, helps the union torpedo changes it does not like. It was Senator Ricardo Aldana, the Pemex treasurer, who held up the legislative response to Fox's proposal. He refused to support the reform until the PRI agreed to eliminate the proposal to place independent experts "free of conflicts of interest" on the Pemex board. Like many other PRI legislators, he claimed that restructuring the board was the first step toward the privatization of the national patrimony.⁸⁰

POLITICAL REFORMS AND POLICY OUTCOMES

4.25 Our analysis so far has emphasized that the observed cases of reform failures are often due to resistance by vested interest groups that have enjoyed privileged access to state rents. In this chapter, we have also argued that the oft-mentioned problem of reform paralysis as a direct result of divided government is likely over-stated. Nonetheless, within Mexico, much of the ongoing debate on the efficacy of the state emphasizes designing the state's constitutional structure to better enable the government to make progress with pending reforms. To remove institutional obstacles that they believe hinder reform, different actors from academia, the private sector, civil society, and the political class have proposed a number of reforms.

⁷⁹ "Aprueban diputados reforma de Pemex," *Reforma* (October 21, 2005): 10A.

⁸⁰ "Encorchetan la nueva ley de Pemex," *Reforma* (November 8, 2005).

4.26 In this final section of the chapter, we review these different options considered today in Mexico. These can be separated between those reforms intended to make government decision-making more efficient (e.g., by encouraging inter-branch cooperation between the executive and the congress) and those intended to improve politicians' responsiveness to their electorate (e.g., by changing the electoral rule). As the following discussion shows, most of the existing proposals are geared to the first objective, reflecting the widespread concern that the Mexican state has lost "efficacy" in its ability to arrive at major political and policy decisions. However, all of the reforms inevitably affect the policy incentives of political actors. This section therefore evaluates the reforms on both counts: are they likely to increase legislative efficacy; and are they likely to give decision makers the incentive to undertake policy reforms in the broad public interest.

Proposals Intended to Make Government Decision-making More Efficient

Strengthening the President's Constitutional Powers

4.27 According to the 1917 constitution, the Mexican presidency has limited formal powers. For example, when discussing the executive-legislative relationships in Mexico, Casar (1999) argues that the legislative powers of the president are not extraordinary when compared to other countries, but that this was compensated by what he termed "meta constitutional" powers of the president that relied on his status as the head of the PRI.⁸¹ The transition to democratic governance shifted this paradigm. The president no longer controls congress, decentralization is underway, and a number of mechanisms of checks and balances are in place, and yet predictable working relationships among these actors have yet to be established. Some therefore argue that formal powers of the president should be augmented to fill the power "vacuum" created by the transition to democratic governance.

4.28 For example, Mexican presidents have the authority to present legislative initiatives to Congress. However, many times, if political agreements do not exist, congressmen may ignore presidential initiatives – without even discussing them in their sessions. In other presidential democracies (though not in the United States), presidents often have the power to force the legislative agenda by, for example, submitting an executive decree whose deliberation takes precedence over other pending bills in Congress. In order to give the president greater agenda-setting power, Negretto (2006) proposes a "fast-track" instrument (*iniciativas urgentes*), which obliges congressmen to

⁸¹ Unlike his counterparts in other presidential democracies, the president in Mexico does not have the authority to call for extraordinary sessions of Congress and has no authority to call for a popular referendum.

take a public position regarding an initiative within a pre-defined timeframe. This reform ensures the discussion of reforms, but not their success.⁸²

4.29 Perceived abuse of such agenda-setting authorities (often via presidential decrees) has been criticized. In Brazil, for example, presidential decrees (*medidas provisórias*) can change the deliberation agenda in congress since these can “jump” the queue and be deliberated on before other pending bills. This strengthens the president’s ability to force debates on specific policy proposals, but it also delays deliberations of other important bills.

4.30 These are modest reforms. For example, they would permit the Congress to amend presidential initiatives no differently than other legislative proposals. Again in Brazil, the presidential decrees that are not converted into laws within the specific period automatically expire. A stronger proposal (requiring an up or down vote on presidential initiatives) would, on the other hand, represent a higher degree of presidential authority than is found in nearly any other presidential democracy. There are no data available to evaluate the effect of either reform on legislative productivity or on the elimination of inequitable or growth-suppressing policy distortions. It is also not clear how such reforms would affect political incentives to pursue policy reforms.

Moving towards a Parliamentary System

4.31 The most radical proposal that is currently entertained is to adopt a parliamentary system of government. This reform can have substantial effects on both legislative efficacy and incentives to undertake reforms in the public interest. A parliamentary system could reduce political fragmentation and the risks of divided government when the government enjoys an outright majority (as in UK-style majoritarian systems). Some suggest that coalition governments in a parliamentary system can make policies more effectively than can presidents and legislatures working together (Linz 1994). Most importantly, in a parliamentary system, the loss of confidence in the government can trigger general elections or reconstitution of the government to renew its mandate. This gives a coalition government in a parliamentary system a stronger motivation for legislative efficacy than exists in a divided government in a presidential system. There is also a belief that parliamentarianism increases government legitimacy and encourages a consensus-based approach to governance.⁸³

⁸² A flip side of the proposal to strengthen the president’s legislative powers is to formalize additional mechanisms of checks and balances so as to promote greater dialogue and collaboration between the executive and the legislative branches. For example, Negretto (2006) proposes an adoption of a procedure for cabinet appointments similar to the US model, which mandates that the Senate endorse cabinet nominations by the president.

⁸³ However, parliamentary systems also entail some limitations (such as higher levels of political volatility), which seem not to be taken into consideration in the current debate in Mexico.

4.32 As a less radical variant of the proposal to move to a parliamentary system, others think that the lack of consensus and coalition building can be addressed by creating the new position of head of government, responsible for running the day-to-day affairs of political and policy coordination on behalf of the president. Specific proposals range from establishment of a vice presidency to a chief of staff, to a prime minister. A vice president, who would also be the head of the Senate, would allow the executive to better interact with the legislature. A chief of staff would help the president better coordinate his or her agenda among the different agencies of the executive, as well as, keep a channel of dialogue open with key actors in Congress. A prime minister would allow for establishing coalition governments by providing the second party with an important post in government. The French experience, from which these reforms are taken, makes clear, however, that the role of the prime minister is minor when the prime minister comes from the president's party. When the prime minister is not from the president's party (*cohabitation*), reflecting the lack of a presidential party majority in the legislature, legislative efficacy and reform enthusiasm appear to be no greater than if there were no prime minister.

Changing Electoral Rules for Presidential Elections

4.33 When an elected politician's margin of victory is slight, the legitimacy of the victory is more likely to be called into question. When the politician is a president, this threatens his or her ability to govern the country. Comparing recent controversial presidential elections in the United States and Mexico, it becomes immediately clear that the threat of legitimacy is greater in countries with a relatively short history of "clean" elections. Many Mexicans therefore propose moving towards an absolute majority system, establishing a second round vote, if needed. This reform restores legitimacy in those cases where a large fraction of the population believes that the winner in the first round secured victory only because his or her opponents divided their support between multiple losing candidates. However, in the case where a country is truly polarized into two or more roughly equal blocs (say, right wing and left wing) the introduction of a second round may not have a material effect on legitimacy.

4.34 The absolute majority system that requires a second round unless the winning candidate in the first round has more than 50% of the votes (or at least a sufficiently large margin of victory over the second-place candidate) presents a number of limitations. One of these is the proliferation of small parties. In a single-round election, some supporters of a small party may cast their votes not for their own preferred party, which has virtually no chance of winning the presidency, but instead for their second-best choice in order to prevent their least favorite party from winning. The introduction of a second round election, however, means that the supporters of the third party lose nothing by voting for their most preferred party in the first round: they still have a chance to choose between the leading two candidates in the second round, even if their preferred candidate did not advance to the second round.

4.35 The introduction of a second round also encourages the entry of parties whose strategic interests are not in actually winning the presidency but in later negotiating their support in exchange for some reciprocal benefits (e.g., attractive cabinet posts) (Shugart and Taagepera 1994). If these small parties are undisciplined (e.g., seeking a share of rent rather than pursuit of a specific policy agenda), the introduction of a second round actually compromises, rather than improves, the president's ability to govern.

4.36 A related proposal is to synchronize national and sub-national elections. Non-concurrent elections increase the likelihood that voters cast their votes in national and sub-national elections with different criteria (simply because the non-concurrence reduces the likelihood that common issues will influence their voting decisions between the two levels, as they might if the elections were concurrent). Recognizing the challenge of aligning national policies with sub-national political realities, some advocate adjusting the timing of national and sub-national electoral cycles. This would increase the likelihood that outcomes of sub-national elections will be influenced, at least to some extent, by the national-level campaign, and thus the favor the president's political allies. To the extent the ongoing political opening further empowers Mexico's sub-national political actors, a higher degree of political alignment between the national executive and the sub-national governments could facilitate coalition building for key policy reforms that involve sub-national actors (e.g., fiscal reform).

Measures Intended to Make Elected Officials More Representative or Responsive

Revisiting the Representation System for Congress

4.37 Mexico's legislators are elected in a mixed electoral system where 300 out of the 500 representatives in the lower chamber are elected in a plurality "winner-take-all" system in their own districts and the remaining 200 are elected on the basis of proportional representation from a national list. In the Senate, 96 senators are elected directly in their own states (2 representing the winning party and one for the second most voted party) and additional 32 are proportionally elected on a national list. For this system to work, Mexico combines two different sets of rules and formulas to translate popular votes into congressional seats (Negretto 2006).

4.38 This system combines two well-known shortcomings of each mechanism. The district system weakens the overall proportionality of seats vis-à-vis the shares of votes the parties receive in elections since a number of votes are "wasted" in each district. PRI, as the dominant party, long enjoyed this effect because the loss in its vote share in specific districts did not immediately translate into corresponding losses in its share of congressional seats. The proportional representation system based on a national list of candidates that party leadership chooses is often criticized for weakening elected legislators' incentives to be responsive to their constituency because the voters essentially vote for parties (rather than individual candidates) and it is the party

leadership that decides who gets to be in the party list. Again, given the history of PRI's strong control of its candidates and limited responsiveness to ordinary voters, the concern about candidate responsiveness is a strong one in Mexico, though it was precisely to moderate both distortions that Mexico introduced a mixed system.

4.39 Two different alternatives are discussed among Mexicans to correct these situations. First, some argue that switching to a full plurality system – a la Americana – may help attenuate the problem of politician responsiveness to voters. However, many have also realized that this reform may undermine the ability of political parties to keep their members aligned in Congress, which in turn may affect the chances for credible commitments and coalition building between parties. Second, Negretto (2006) and others proposed the possibility of having citizens vote in separate ballots for (a) proportional representation and (b) district representatives.

Shortening Terms and Relaxing Term Limits

4.40 Critics of presidential systems state that when presidents lose popular support, citizens need to wait until his or her period finishes, putting the whole country “on hold.” They also argue that the longer the presidential term, the higher the chances of having a “lame-duck” president and pressure for extra-constitutional means of removing an ineffective incumbent (e.g., popular unrest, early resignation), as witnessed in a number of Latin American countries during the last decade. Following this rationale, Negretto (2006) advocates shortening the presidential term in Mexico, from 6 to 4 years.

4.41 Some combine the proposal to shorten the presidential term with the popular notion of relaxing term limits. Proponents of reelection state that by allowing political actors to seek reelection, their accountability and responsiveness towards their constituency would be improved. Providing them with actual chances of being reelected would align their incentives with the interests of the voters. Allowing legislators to “stay longer in Congress” will also help create the necessary capacity to perform their task in a more effective way. While most of those in favor of this constitutional change mainly focus on re-establishing reelection for mayors and legislators, some also propose to include governors into this reform. Rarely, however, have proponents advocated the reelection of the president.

Political Institutions and Policy Outcomes: Preliminary Empirical Findings

4.42 As the brief review above shows, a variety of proposals for reforming aspects of Mexico's political institutions are being debated. Although some reforms appear to be contradictory (greater presidential powers vs. introduction of a parliamentary system), in fact their purpose is mostly the same: to reduce the number of political checks and balances in the system, removing obstacles to more fluid decision making. Measures to strengthen the president *or* the legislature would have this effect. The alignment of

electoral calendars would make it more likely that the same party would succeed in both national and state elections. A second round of voting could strengthen the mandate of the eventual winner and increase incentives for parties to coalesce (but after the likelihood of initial party proliferation). The relaxation of term limits seems to arise mostly from the concern about legislators' perceived lack of responsiveness to their constituencies. But, to the extent that it would strengthen party discipline – it would if the parties control candidate nomination, but would not if candidate selection were based on local popularity – it would also reduce the number of political actors who could veto reform. All of these strengthen some actors relative to others and minimize party fractionalization or its effects in the legislature.

4.43 All of the institutional changes under consideration also have the potential to substantially shift political incentives, particularly their incentives to appeal to narrow or to broad social interests. The direction of that shift, however, is ambiguous. A few examples highlight this ambiguity.

- The district-based system advocated by some can strengthen the ability of voters to hold individual legislators accountable for their actions (especially if they can run for reelection), but the legislators may choose to respond to their local constituencies by offering patronage or other benefits that may not necessarily further general welfare of the population at large (e.g., “pork barrel” projects).
- Closed-list proportional representation electoral systems with multi-member districts vest greater authority with political parties, which tend to have incentives to appeal to broader constituencies, more consonant with the broad public interest, than individual legislators (but the extent to which political parties pursue broad public interests depends on how broad their support bases are in terms of geographic coverage, appeals to different socioeconomic classes, and so on). Political parties operating with closed-list PR system could, however, develop into a party system that is not responsive to citizens, if established parties choose candidates purely to reward those who have somehow established themselves within the parties rather than to choose those who can best represent the policy proposals of the parties. These risks are particularly high when obstacles to electoral accountability reduce pressure on parties to perform well in government.
- Parliamentary government makes it easier for political actors to make credible agreements with each other (the interests of the executive and legislative branches are more closely aligned in parliamentary elections), promoting reform bargains (Persson and Tabellini 2000). However, it also facilitates collusive behavior by parties in the absence of effective institutional checks and balances as in presidential systems. This can perpetuate distortionary policies or even corruption.
- Relaxing term limits may improve party discipline, enhancing the ability of parties to carry through their broad-based reform agenda. It may allow voters to impose a

cost on non-performing politicians (by refusing to re-elect them). At the same time, though, entrenched politicians may be able to stave off electoral challenges simply by relying on incumbent advantages (e.g., directing state resources to bring particularistic benefits to their local constituencies) and without contributing to the country's general welfare.

4.44 Empirical evidence on these questions is also mixed. The strongest results indicate that countries with parliamentary forms of government spend more and have more generous social spending than those with presidential or semi-presidential systems, but this characteristic has no systematic effects on corruption. The evidence on the effects of electoral rules is also mixed: plurality is associated with worse corruption and social outcomes, but stronger rule of law and higher bureaucratic quality compared to proportional representation.

4.45 Chapter 2 (Table 2.3) and Chapter 3 (Table 3.1) present results of regression analyses to highlight some of the major policies in which Mexican performance differs substantially from other democracies, sometimes for the better, but often for the worse. In the context of democratic consolidation and proposed political reforms, three questions arise in the context of those previous statistical analyses. First, are the political reforms under consideration in Mexico associated with differences across countries with respect to these policies? The foregoing discussion concludes that in many cases the policy effects of institutional reforms is ambiguous, underlining the importance of identifying empirically systematic relationships between political institutions and policy outcomes. Second, do more consolidated democracies perform differently than others? The simple fact that a democracy has endured for more years may have significant effects on the ability of voters to hold politicians accountable for the welfare consequences of their policy decisions. Because voters in mature democracies better understand which politicians are responsible for which decisions, older political parties are more likely to rely on policy reputations rather than clientelistic appeals to secure voter support. And third, do Mexico's political institutions and degree of democratic consolidation account for the significant deviation of Mexico's policy performance from that of other countries?

4.46 To answer these questions, we can take advantage of existing cross-country data on some of the institutional reforms under consideration in Mexico and data on democratic consolidation.⁸⁴ The variables that capture specific characteristics of political institutions are added jointly to the regressions in Tables 2.3 and 3.1. The results are reported in Tables 4.7 and 4.8, below. None of these regressions are sufficient to say that particular institutional reforms will inevitably lead politicians to improve the policies

⁸⁴ The Database of Political Institutions (Beck, et al. 2001). Democratic consolidation is measured using the number of years of continuous competitive elections a country has experienced. This variable captures the effect of democratic consolidation: the extent to which political parties and actors have had an opportunity to make and implement credible promises and, more generally, to make the institutions of democracy more generally acceptable and credible to citizens.

analyzed here. It is possible that unobserved characteristics of countries that influence whether they adopt particular institutional arrangements also influence the policy choices they make.⁸⁵ It is also plausible that effects of institutional change are more pronounced when reforms combined in specific ways. Nevertheless the results are illustrative, at least, of the ambiguous causal relationships between political institutions and policy performance in democratic countries.

Table 4.7 Political Institutions, Democratic Consolidation, and Policy Performance

		Public health expenditures/ GDP, 2003		Tax revenues/ GDP, 2000		Corruption (1-worst, 6- best), 2004		Infant Mortality, 2004	
<i>Mexico</i> (0-1)	<i>Mexico</i> (0-1) from Table 2.3	.34 (.63)	-.84 (3.32)	-2.65 (.86)	-6.7 (3.10)	.07 (.30)	-.58 (4.43)	-5.97 (.87)	-12.55 (3.62)
Years of continuous competitive elections		.06 (2.20)		-.03 (.17)		.02 (2.81)		-.30 (2.60)	
District magnitude		.0003 (.10)		-.03 (.88)		-.0007 (.21)		.008 (0.18)	
Electoral system (0=PR, 1=plurality)		-.64 (2.10)		.64 (.22)		-.11 (.55)		2.17 (.44)	
Political system (0=presidential, 1=semi-presidential, 2=parliamentary)		.37 (1.61)		-3.37 (1.43)		-.03 (-.26)		-3.30 (1.15)	
Can the executive seek another term? (0 if no, 1 if yes)		-.05 (0.11)		10.05 (2.21)		.32 (1.44)		17.47 (2.18)	
N		92		53		84		90	
R ²		.68		.24		.64		.71	

NB: The specification in this table is the same as in Table 2.3 and only considers countries with competitive elections. Other variables in Table 3.1 (income per capita, land area, etc.) are also controlled for here, but are not reported. Constants not reported. A positive Mexico coefficient indicates the amount by which the actual Mexico outcome exceeds comparator countries; a negative, by how much it falls short of comparator countries. *t*-statistics in parentheses. White-corrected robust standard errors.

⁸⁵ Keefer (2006) provides evidence of a causal relationship between the years of continuous elections and improved policy outcomes in areas such as corruption and education.

Table 4.8 Institutions, Democratic Consolidation and the Environment for Job Creation in Mexico (2004)

		Costs of starting a business/GDP per capita (%)		Index of difficulty of firing workers (0 – 100)		Costs of firing a worker/GDP per capita (%)		Index of employment rigidity (0-100)	
Mexico (0-1)	<i>Mexico (0-1) from Table 3.1</i>	-40.22 (2.03)	-38.2 (4.56)	44.84 (5.06)	33.10 (7.87)	24.83 (1.76)	16.17 (1.87)	16.95 (2.37)	9.78 (3.12)
Years of continuous competitive elections		-1.06 (1.13)		.05 (0.11)		.17 (.22)		-.17 (-.51)	
District magnitude		-.01 (.14)		.09 (1.24)		-.18 (1.64)		.002 (.06)	
Electoral system (0=PR, 1=plurality)		-20.36 (2.02)		-7.06 (1.43)		-16.34 (1.57)		-14.24 (3.38)	
Political system (0=presidential, 1=semi-presidential, 2=parliamentary)		-6.06 (1.21)		-7.17 (2.05)		-6.70 (1.20)		-3.82 (1.60)	
Can the executive seek another term? (0 if no, 1 if yes)		-5.68 (0.31)		14.08 (1.72)		1.00 (.07)		1.16 (.20)	
<i>N</i>		81		80		81		80	
<i>R</i> ²		.55		.27		.29		.33	

NB: The specification in this table is the same as in Table 2.3 and only considers countries with competitive elections. Other variables in Table 3.1 (income per capita, land area, etc.) are also controlled for here, but are not reported. Constants not reported. A positive Mexico coefficient indicates the amount by which the actual Mexico outcome exceeds comparator countries; a negative, by how much it falls short of comparator countries. *t*-statistics in parentheses. White-corrected robust standard errors.

4.47 First, political explanations fully account for the deviations of Mexican spending and social indicators from the average, but not for the deviations in obstacles to doing business. In the specifications of Table 4.7, which take into account a range of political explanations for cross-country differences in these variables, the Mexico coefficient is nowhere statistically significant and much smaller in magnitude (i.e., some of the political variables explain Mexico's policy performance vis-à-vis other countries). However, it is more difficult to account for the strikingly low costs of starting a business in Mexico relative to comparable countries, and the significantly more rigid labor regulations that prevail in Mexico.

4.48 There are two possible explanations for why the Mexico coefficient remains significant in Table 4.8, even after controlling for political differences across countries

(i.e., the characteristics of Mexico's political institutions do not account for the observed differences Mexico's business environment from that of other countries). On the one hand, the political battle over labor regulations entails a conflict *between* special interests – organized firms and organized workers. We have no data on the extent and influence of firm and worker organizations across countries, and the political variables included in this analysis tend to capture politicians' incentives vis-à-vis voters in general. Mexico, however, appears to stand out in the extent and influence of its organized labor, a legacy of PRI hegemony, and would continue to stand out until adequate controls for special interest organization are included.

4.49 On the other hand, the indicators are *de jure* measures of obstacles to doing business. These are likely to be associated with *de facto* measures of the actual experience of firms only in countries where formal institutions shape government decision making. For example, we would expect that if formal laws and regulations mattered on the ground, the statutory costs of firing a worker and the index of statutory difficulties in firing a worker would be correlated.⁸⁶ This is true in older, more consolidated democracies (those with average continuous years of competitive elections of 15 years or more), for which the 2004 correlation is .34. In younger, less consolidated democracies, however, the two variables are entirely uncorrelated (the correlation coefficient is -.02). To the extent that *de jure* regulations are not meaningful, their genesis is less easy to explain.

4.50 The second lesson from the two tables is that formal political institutions have inconsistent effects on outcomes. Table 4.7 demonstrates that countries with plurality electoral systems also have lower obstacles to entrepreneurial activity and job creation. The effects are similar, but weaker, for parliamentary systems. However, plurality systems are also associated with lower health expenditures and parliamentary systems with lower tax revenues. In addition, the institutional variables are not statistically significant across similar variables. For example, though plurality rules significantly predict less employment rigidity, they are insignificant determinants of firing conditions. On balance, the evidence suggests that plurality electoral systems and parliamentary systems can be helpful, but are no panacea. This reflects exactly the ambiguity of the theoretical predictions described earlier, which point to the offsetting incentive effects of these institutions.

4.51 In contrast, the reelection of the chief executive seems to be weakly associated with more negative outcomes. On the one hand, in countries where the chief executive

⁸⁶ The statutory costs of firing a worker are essentially the salary costs of the period of advance notice plus severance pay. The index of firing difficulties captures whether termination is possible at all, whether notification of government agencies is required, or whether their approval is required. If formal regulations mattered and were intended to benefit workers, they would be positively correlated. If formal regulations mattered and were intended to create opportunities for regulators, we would expect a negative correlation: high values of the second – requirements that firms seek approval from regulators – and low values of the first – requirements that firms pay workers. Neither is true for young democracies.

can be re-elected, tax revenues are significantly higher. Since tax collection is a serious problem in Mexico, this suggests that the relaxation of term limits would be a positive institutional reform for the country. However, there is no evidence that chief executives who are able to seek another term in office use extra tax revenues to improve public welfare. One way to see this is that expenditures on health care are negatively associated with the absence of term limits and infant mortality is positively associated with their absence. In addition, from Table 4.8, political systems where chief executives are able to seek another term in office do not have lower costs of doing business (in these cases the costs of firing workers also tend to be high). These results are difficult to interpret in a straightforward way, but it may be that the possibility of reelection in places where voters are uninformed, for example, or politics are clientelistic, reelection incentives do not drive chief executives to pursue the public interest. In any case, the available data are sufficient to reject the claim that the reelection of the executive is sufficient to yield significantly more public-regarding policies; they are insufficient to test explanations for the reasons for this failure.

4.52 The third lesson concerns the effects of democratic consolidation, particularly important for new democracies, independent of the specific institutional choices of countries. Countries that experience more years of continuous competitive elections also exhibit greater public health expenditures, less corruption and less infant mortality. In more consolidated democracies, the incentives of politicians to satisfy broad public interests are greater and the political costs of self-seeking actions, including corruption, are also greater. Among the variables added to Table 4.7, it is precisely the introduction of the years of continuous competitive elections that substantially reduces the Mexico coefficient (i.e., the fact that Mexico has had fewer years of competitive elections explain its relatively poorer policy performance).⁸⁷ In sum, democratic consolidation matters where we might expect it to; both theory and evidence underline the ambiguity of the net effects of institutional reforms.

SUMMARY

4.53 The political system's inability to pass pending structural reforms is obviously a cause for concern, especially since these are expected to benefit the society as a whole. The consensus in the country is that Mexico needs certain economic reforms to strengthen its competitiveness in the global economy, a necessary pre-condition for economic growth and employment generation. What is not clear is the source of the "reform paralysis." A number of observers have pointed their fingers at institutional weaknesses of the Mexican state, especially the difficulties the executive branch has had

⁸⁷ Of the additional variables in Table 4.7 compared to Table 2.3, only years of continuous competitive elections is significant; hence, the interpretation that the introduction of this variable explains the drop in the Mexico coefficient. The same conclusion holds if one simply omits the institutional variables and focuses only on the addition of the consolidation variable.

in forging consensus and form a sufficient legislative coalition in Congress to pass reform bills.

4.54 The information on “legislative productivity” we have collected shows evidence of a slowdown in constitutional reforms, which are needed for some of the pending reforms such as a comprehensive reform of the petroleum sector. It also shows that the number of federal laws passed (either anew or as revisions to existing laws) actually increased during the period of divided government because of the heightened legislative activities of the political parties. It is therefore unlikely that the main source of the reform paralysis is in the institutional design of executive-legislative relations. In fact, reform attempts have failed even when forging a sufficient reform coalition in Congress was imminent. This was the case of the failed tax reform in 2005, which fell apart at the eleventh hour because the PRI split internally due to its internal struggle over the party’s leadership. A more obvious example of extra-institutional obstacles to reform was the case of the IMSS reform in 2004-5, which actually passed as law, only to have its content diluted by the strong-arm resistance of the IMSS union. Finally, reforms sometimes fail not because of opposition (either on the legislative floor, as the gridlock thesis would posit, “behind closed doors” as evidenced in the role of IMSS union in the above-mentioned case, or from public opinion), but because of lack of legislator interest. In the case of the aborted comprehensive public security reform mentioned in Chapter 2, the fate of the bill appeared to be determined by the sheer lack of political imperative among the legislators to prioritize its discussion (and subsequent passage) in spite of the high salience of the topic among the general public.

4.55 The statistical analysis of policy effects of different institutional choices shows ambiguous results. Some institutional designs are associated with positive or negative outcomes in certain policy areas, but other designs matter in other areas. There is no clear-cut evidence that shows superiority of any particular institutional option.

4.56 Therefore, while remaining agnostic about whether the interactions among key institutional actors such as the presidency and the Congress could be improved with some focused institutional reforms, we contend that the core of the governance problems in Mexico, both in terms of the demonstrated difficulty in strengthening the state’s capacity to provide public goods and passing contentious economic reforms, has its roots in the country’s socio-political reality. The political polarization of the Mexican population so clearly demonstrated in the last presidential election is an aspect of this reality that is not directly due to the structure of Mexico’s political institutions. Another source of governance challenges is the undue influence of specific interest groups which have long benefited from privileged access to public rents and possess a variety of extra-institutional means to resist change (e.g., threat of strikes, money).

4.57 One variable that shows up as statistically significant in our regression analysis on public spending and corruption is the degree of democratic consolidation, measured as the number of continuous years that a country has had competitive elections. The

more consolidated the democracy (i.e., the longer the years with competitive elections), the better the policy performance. But to say that democratic consolidation improves governance is not to resign oneself to the view that Mexico simply has to wait for decades to see its political system mature. Instead, it suggests that we probe more deeply to understand what about consolidated democracies contributes to better governance and in what ways Mexico lacks some of these positive attributes of mature democracies. In the final chapter that follows, we offer our interpretation of the relevant elements of democratic consolidation as they affect governance, and our assessment of where Mexico stands in that regard.

5. OBSTACLES TO FULL ELECTORAL ACCOUNTABILITY AND PRIORITIES FOR REFORM

5.1 The analyses presented so far sketch a complex picture of the state of democratic politics and electoral accountability in Mexico. In many areas, for example those related to competitiveness and economic growth, electoral pressures have not spurred reforms. The tax base remains narrow and exemptions for special interests continue to proliferate, while significant barriers to entry continue to protect incumbent enterprises and workers from competition and inefficiency of the existing utility monopolies raises costs of doing businesses for all. Government policy has moved in a pro-poor direction in sectors such as health and education, and governments have exerted significant efforts to respond to citizen demands for better public security. But these efforts have not yielded substantial progress on the ground and, for want of revenue reforms, have been financed at the expense of other policy priorities such as infrastructure investments.

5.2 The slow pace of reforms has consumed observers of Mexican politics and has convinced many that institutional reforms to facilitate more efficacious government decision-making (e.g., by strengthening the president's constitutional power vis-à-vis Congress) are needed to speed the pace of structural reforms. This emphasis is likely misplaced. First, as Chapter 4 demonstrates, the most contentious economic reforms have proven to be difficult under the different institutional settings characterizing the periods both during and after PRI hegemony. Besides, solid evidence does not exist to support the view that reengineering of policy-making institutions such as executive-legislative relations will necessarily lead to better policies. Second, the vigorous opposition of special interests has been instrumental in short-circuiting reform effort in both periods, and no political reforms under consideration are likely to mitigate their influence (nor do they seem intended to do so).

5.3 As illustrated in Chapters 2 and 3, the capacity of special interests to mobilize resistance outside of formal electoral and legislative arenas weakens the accountability effects of elections. For example, this has taken the forms of overt or behind-the-door resistance by public sector unions (although the unions are not by any means the only "special interests" with capacities to obstruct reforms, nor are all unions equally and always obstructionist) as well as apparent exercise of monetary influence and personal connections by certain economic elites to preserve or even increase their rents and privileges. These resistances not only block or dilute reforms when they are attempted, but they naturally make politicians reluctant to take on ambitious reform agenda in the first place, knowing the difficulty of overcoming special interest pressure. In turn, the voters can (rightly) grow skeptical of politicians' ability to overcome the resistance and start asking for tangible, particularistic benefits rather than fundamental reforms that

could improve the country's general welfare in the long run but might not be passed anyway.

5.4 A logical way out of this situation would be to somehow weaken these vested interests, and simultaneously strengthen the weight of the influence of the general public. Certain economic and sectoral reforms could achieve the first objective, although ironically it is these same reforms that the special interests block precisely because those reforms affect their vested interests. Somehow establishing effective electoral accountability would achieve the second objective, but here two additional constraints need to be addressed. First, the history of policy-based electoral competitions is still short in Mexico and the parties are only now developing the ability to project coherent, policy stances to voters. The institutional arrangement that evolved during the 71 years of the PRI system was not geared toward promoting such electoral competition and accountability. Second, voter polarization and poverty, products of the evolution of Mexico's socioeconomic structure, undermine the extent to which elections can revolve around competing policy proposals by political parties and candidates.⁸⁸ In this sense, unfortunately, the highly charged dispute over the result of the last presidential election bodes ill for fostering the credibility of Mexico's electoral process, and thus some voters' faith in it as a main instrument for exercising their democratic rights.

5.5 It is important for Mexico to move quickly to address these remaining challenges. If the extra-institutional influences on policy making and political processes in general dominate citizen perceptions of how decisions are made, this will reverse the admirable progress that has been made in deepening the democratic political process. In our view, a fundamental governance challenge in Mexico is not to overhaul the constitutional structure of the Mexican state so as to make the state more "efficient," but rather to continue nurturing the beneficial effects of policy-based political competition so that general citizens' wishes are efficiently translated into government policies through effective functioning of electoral accountability.

5.6 The strong presence of special interests sets in motion a vicious circle whereby the difficulty of reforms generates cynicism among voters, who in turn stop demanding reforms, and thus help perpetuate the privileged positions of these special interest groups.⁸⁹ Experiences (e.g., the Asian financial crisis, the banking sector reform in

⁸⁸ In political science, there is an emerging consensus that the nature of the political parties, or the party system, matters for the quality of governance (Mainwaring and Scully 1995). In a recent publication of the topics of politics and policies, the IDB concluded that "(P)arty systems influence the workability of executive-legislative relations, the possibilities for coordination in Congress, and *the incentives of elected officials to cater to narrower or broader sets of social interests*" (emphasis added). Of particular interest here is the extent to which the parties are "programmatic," that is, the extent to which the parties compete with each other on the basis of substantive policy proposals (e.g., higher spending for redistribution vs. tax cuts for promotion of business activities, tougher stance on crimes vs. emphasis on preventive programs and social rehabilitation).

⁸⁹ If parties and voters both know that implementation of a range of reforms is not possible, they are likely to turn away from policy-based competition and turn towards clientelistic electoral strategies (e.g., based on

Mexico itself) show that often it takes a painful crisis to change this negative equilibrium. A particular challenge for Mexico is to move away from this situation without such external shocks that somehow unsettle the existing equilibrium of power, influence and rent-seeking.

OVERCOMING LEGACIES OF CORPORATISM AND STATE-LED CAPITALISM

5.7 In every country, special interests help politicians with financial resources and with direct assistance in contacting and organizing voters. Politicians and citizens legitimately credit special interests with having expert information about the sector, but interests can exploit this for policy advantage. Special interests can themselves represent dedicated voting blocs, able to commit to vote on the basis of a single issue. These are all normal and unavoidable characteristics of democratic political competition that are present in even the most successful democracies. In Mexico, however, the legacy of corporatism and state-led capitalism where the well-connected thrived under state protection and rent sharing has amplified the ability of vested interests to use extra-institutional tactics to influence policy to an extraordinary level.

Public Sector Unions as Special Interests

5.8 In general, special interests have more scope for extraordinary political influence in areas where the policy content is complex and where they can use extra-institutional pressure to impose large costs on society. For example, in education and public security, the relationship between government inputs and policy outcomes are complex and particularly difficult to discern, even for experts, let alone for ordinary citizens. Reform efforts are handicapped by a lack of information about the connection between government inputs (e.g., the number of armed police officers and teachers) and policy outputs (e.g., public security and student learning). Even the ability of politicians to monitor effort and productivity is weak. For example, it is difficult to monitor how police officers behave on patrol or how teachers teach in classrooms.

5.9 If, in addition to this incomplete information, organized sectors wield substantial power, reforms can be stifled. In public security, the significant extra-institutional influence of the sector employees produced police inaction in protest to reform initiatives in the Federal District during the Cardenas administration. This led to skyrocketing crime and an admission by the police chief that the 40,000 member force was out of control. The cost to citizens of the struggle to implement reform appeared to outweigh the potential long-term benefits of the reform. In the worst cases, as in the cases of attempted reforms of the IMSS and the education sector cited above, bureaucratic organization and willingness to resort to extra-institutional forms of opposition have enabled these groups to block or dilute reforms that are meant to

the promise of handouts, jobs and projects to small groups of voters); or to populist proposals that may be more easily implemented, but that exclude reform areas most important for the growth and equity (e.g., broad-based subsidies rather than tax and education reform, for example).

improve the state's capacity to provide essential public services to benefit a majority of Mexicans.

5.10 Influence of these groups is determined by a combination of factors including their numerical strength, their financial clout, and their ability to control key points in a policy process. It is also derived from formal bargaining powers granted by policy or legal decisions. For example, teachers in Oaxaca are legally allowed to collect their salaries while striking indefinitely, and are able to strike on issues unrelated to their working conditions, or even to education. This bargaining power was not granted in a democratic process by all Mexicans to teachers; instead, it is a legacy of the period of PRI hegemony. The political costs of reform (e.g., in education) will continue to be high if groups inside the public sector enjoy bargaining power far above the public sector average in well-performing countries.

Economic Elites as Special Interests

5.11 Another type of special interests we identified in this report are certain economic elites who are able to influence government decisions using their wealth. Money influences politics in numerous ways and the role of money in politics is arguably more pronounced in political systems where political and economic elites have traditionally maintained close symbiotic relations as in Mexico.⁹⁰ Some of these sources of influence might be expected to diminish with elections. For example, elections should make it easier for politicians who pursue policies that hurt the majority in exchange for bribes from a special interest to be defeated by politicians who refuse those bribes and satisfy the majority. On the other hand, the resources needed to run for office are obviously greater in a democracy than in a non-democracy (where politicians do not need to run for office in the first place).

5.12 Mexico has undertaken significant efforts to mitigate the influence of money on political decision making, with some of the most generous public financing of elections in the world and with fairly strict oversight of campaign spending by a reputable independent agency. Though subject to criticism, this agency is as technocratic and well-funded as any such agency in the world. Still, though direct evidence is scarce, there are several reasons to believe that money (and economic influence in general) has

⁹⁰ It can persuade politicians who need resources to run for office or who would like to improve their personal standard of living. It can affect media reports and public opinion; it can be used to make private deals with officials that circumvent political parties and normal financing channels; moneyed interests can provide lucrative employment or contracts to cooperative officials after they leave office, or to their relatives while they are in office; they can finance demonstrations and other extra-institutional sources of pressure on governments; or they can make private contributions that assist officials in achieving their political goals (e.g., urban renewal, the provision of expertise). Finally, moneyed interests can directly influence the evolution of the economy and public perceptions of government performance, by reducing the supply of staples or the pace of job-creating investment, by raising prices or by lowering them.

an important effect on policy outcomes and the pace of reform in Mexico, even if this influence is primarily not through the direct financing of electoral campaigns.

5.13 With their concentration of wealth and close contacts with political elites, Mexico's economic interests are uniquely able to influence political outcomes. It is evident that in the past their influence has been great. These groups' political influence is difficult to measure objectively. Circumstantial evidence suggests, however, that their influence may have increased since the political opening. First of all, today's rich business elites are far more affluent than their counterparts of the yester years. Second, the government-business relations in Mexico have improved since the early 1990s. Until then, while each was dependent on the other in the closed, state-led economy, their relations were filled with mistrust and conflict (e.g., as exemplified in the sudden nationalization of the banking sector in 1982). The smoother government-business relations are expected to provide the economic elites with even better access to government decision-making than in the past.

Reform Priorities to Counter Special Interests' Influence in Politics

5.14 An obvious policy priority that emerges from this analysis is to somehow curb the strong influence of special interests in Mexican politics. This is obviously far easier said than done. Frontal confrontations are probably not necessary, and certainly not desirable. But combining specific transparency measures that bring behavior of these groups under the public light, and well-crafted sectoral reforms that over time change the organizational bases of their power and influence might offer a way forward.

5.15 Special interests thrive outside public scrutiny. By collecting better measures of sector performance, governments can improve citizen understanding of the policy process, the role of these intra-state special interests in producing deficient policy outcomes, and the benefits of reform. For example, crime data in Mexico is entirely deficient and only a fraction of crimes are reported to the police. Without this information, it is impossible to pinpoint areas where the performance of public sector security agencies lags. As a consequence, it is difficult for the public to discern the effectiveness of reform, thereby reducing the political rewards that they give governments which attempt to reform.⁹¹ The Federal District police installed a modern information management system for internal management purposes, but this reform could go a step farther. Making non-sensitive information available to the public would help the citizens appreciate performance of the police force, and thus better assess how well or badly the government efforts to fight crimes are going.

⁹¹ Despite the pressing need for more performance information, however, and although federal subsidies to states for public security have risen by a large amount, these have gone to materials (uniforms, vehicles and equipment), and have not been conditioned on the better provision of information about sector performance.

5.16 In a sector such as education, which is already decentralized, a promising approach would be to work at the state level to implement a program to disseminate information on student achievements and school performance. Some states already have their own education systems. Advancing with teacher accountability in those states could, at least in the long run, bring about positive demonstration effects to other states. To the extent good performance in running a state (or a municipality) becomes an important criteria for political advancement, heads of sub-national governments in a federalist system like Mexico's would naturally find it in their political interests to emulate successful innovations elsewhere. Other reform measures that strengthen relative influence of other actors – for example involving parents through school-based management – could complement information-based approaches to promoting accountability of service providers such as teachers (World Bank 2006a). Here it might be relevant to consider a supplementary institutional arrangement whereby an independent federal entity monitors and reports on state governments' performance in providing key public services. Such an arrangement exists in Australia, where the well-respected federal Productivity Commission annually publishes performance data of the state governments on the ground that they receive federal funding.

5.17 Influence of economic elites could be countered, at least partially, with disclosure of key information related to government-business relations. One type of information is already collected in Mexico and needs to be more widely disseminated: the identities of contributors to campaigns. Another type of information is not collected, but needs to be: the assets of elected officials, their current and past income, and the business activities and customer base from which that income was generated.

5.18 The effect of money in politics is directly related to the concentration of wealth. Numerous reforms advocated in Mexico to improve competitiveness and fairness in the economy all have the additional effect of reducing the concentration of wealth. Vigorous antitrust enforcement, deregulation of obstacles to business entry and exit, and the removal of glaring tax loopholes, all have direct effects on economic outcomes that benefit the majority of Mexicans; they also have indirect effects, by shrinking the influence of economic influence that drives a wedge between voters and politicians. This is a far from an easy recommendation to implement, however: economic elites' influence is used to block the reforms of precisely those policies that perpetuate their privileged positions in politics. Hence, the great importance of beginning with expanded rules that increase public awareness about the role of money and other forms of elite influence (e.g., connections) in politics. These reforms take on some degree of urgency, since to the extent that voters believe that politics is the will of the wealthy, they will cease voting for parties that best represent the broad interests of the country and return to voting for parties that best represent their private, clientelistic interests.

OVERCOMING OBSTACLES TO ELECTORAL ACCOUNTABILITY AND STRENGTHENING THE VOICE OF THE GENERAL PUBLIC

5.19 Reform measures that increase transparency about the organizations and behavior of special interests and well-targeted economic and sectoral reforms that alter their organizational base over time may be able to chip away the excessive influence of these groups. But complementary efforts to strengthen the weight of the general voters in politics are necessary to overcome pervasive special interest influence in Mexican politics. Key is to make electoral competition revolve around substantive policy issues that the general public cares about and to make politicians accountable for offering and, if elected, implementing their policy proposals in a credible way. Mexico appears to be on its way to develop a culture of electoral contests on the basis of alternative policy proposals. But this process is still incomplete, and faces certain obstacles. In this section, we highlight two such obstacles. One is related to Mexico's current state of political competition, which limits citizens' exercise of electoral accountability, and the other to its socioeconomic structure and its effects on the political process. Overcoming these obstacles will be no easier than weakening the influence of well-organized vested interest groups. But we believe these are necessary facets of Mexico's second democratic transition.

Building the Policy Reputations of Parties for Clear Electoral Accountability

5.20 Voters' ability to choose among credible competing policy alternatives is a precondition for electoral accountability. Without the ability to cast their votes on the basis of candidates' credible policy proposals (or on the basis of the incumbent's performance), they will not be able to use their votes in the subsequent elections to reward or punish politicians (or political parties) that achieved/failed to achieve their electoral promises. In most new democracies, establishing this sort of electoral accountability is a challenge because political parties usually emerge with no policy reputations. Instead, parties are often centered on the political appeal of charismatic individuals or on clientelistic promises to small groups of voters or on sectarian appeals. Electoral competition among such parties does not provide voters with the opportunity to penalize politicians who do not promote policies in the broad public interest, since no party offers credible policy promises to win votes. Similarly, electoral accountability suffers when voters themselves are unsure of the policy directions they prefer, perhaps because they are still not used to expressing their preferences through votes and/or because the political debates do not yet take place around concrete policy alternatives.

5.21 In the case of Mexico, the period of gradual political opening in the 1990s was indeed characterized by the limited extent to which inter-party competition was based on credible policy alternatives. Although the PAN and the PRD historically demonstrated fairly clear contrast in their positions on a range of policy issues, the most salient issue in this period, including 2000, was fundamentally a political one about whether to replace the PRI with either opposition party. In fact, available survey data

indicate that voters understood the most important ideological orientation separating the main opposition party (PAN) and the PRI to be, simply, opposition to the PRI (McCann and Lawson 2003). This substantially complicated their vote. For example, poor voters who would otherwise have naturally gravitated to the PRD in 2000 might instead have voted for the PAN, crediting it with a generation or more of opposition to the PRI and/or believing the PAN had a better chance of defeating the PRI.

5.22 The same survey data also revealed that Mexican voters' views on policy issues tended to be unstable over time. For example, an average voter was unsure whether privatization of the energy sector was a good thing for Mexico and how best to deal with public insecurity. Less educated voters demonstrated particularly unstable views about their own ideological convictions (McCann and Lawson 2003). Obviously, when voters themselves are not sure what they want from politicians (candidates), the candidates (or the political parties) themselves are somewhat clueless as to how to appeal to the voters on the basis of policy proposals. Candidates would naturally offer vague promises or try to appeal to the voters on other grounds (e.g., personal image), or alternatively, skillful candidates can shape (manipulate) voters' own perceptions of the issues, including on the basis of partial or even incorrect information.

5.23 The ambiguity in the electoral dynamics between voters and politicians, among other factors, weakens electoral accountability. Not surprisingly, then, during this period of transition, politician (as opposed to party) identity was of significant importance in voting decisions generally in the country. For example, personal contact with politicians was highly valued. A large fraction – twenty percent – of voters report personal contact with candidates or their teams in the 2003 legislative elections (Langston 2005, p. 30). The importance of personal contact – and of investing campaign resources in maximizing personal contact – is highest when programmatic (broad policy) appeals to voters are least effective. In turn, the greater the importance of personal characteristics of candidates, the weaker the effect of elections on government accountability for overall performance.

5.24 Evidence from state level elections also points to the loose connection between government performance and voter support for political parties during this period. If voters credited parties with good performance, then states that have had successful governors from one party would more likely see gubernatorial nominees from that party do well in subsequent elections. Anecdotal evidence suggests this was not often the case. The governors of Chihuahua (1998), Jalisco (2000) and Michoacán (2001) all received positive approval ratings shortly before gubernatorial elections (52 to 61 percent approval). Only in Jalisco, however, did the governor's party win the election for the next governor (Magar and Romero 2006). Parties received strikingly little credit for the performance of their governors, and the individual characteristics of candidates appeared to matter more than their party affiliation.

5.25 The political advantages of credible appeals to voters on broad policy issues are significant, and Mexican parties have worked hard to be able to make them. First, they have tightly controlled party nominations. By carefully vetting candidates, party leaders hoped to identify those whose interests and views most coincided with those of the party. However, this has created a dilemma. While they build programmatic identities, parties still must respond to voters who focus on the individual characteristics of candidates as much as or more than policy stances of parties. “The new dilemma for the party [PAN] under non-consecutive reelection laws is to choose candidates who are popular with the electorate at the same time they have some identification with the party’s principles, and will thus act congruently with them once in power.”⁹²

5.26 Second, the parties retain control over a large fraction of campaign finance, not least because government funding passes through parties and does not flow directly to candidates. Parties use this money in part to build a coherent party identity with voters. According to Langston’s interviews with both central party officials and candidates, “. . . the desire to maintain control over party finances and raise voting numbers across the nation have convinced the parties’ leaders not to devolve advertising responsibilities to the state or district levels. One of the consequences of this centralizing tendency has been to further reduce the individual politician’s capacity to foster a personal vote, because their district media appeals are far less developed than those designed to sell the party as a whole” (Langston 2005, p. 34).

5.27 There is no better way to develop a party’s policy reputation than through actual demonstration of its visions, as well as its capacity to translate those visions into concrete policies. Here again Mexico seems to be on a promising track. Specific policy initiatives have boosted the credibility of party programs in various jurisdictions. As mayor of Mexico City, Andrés Manuel López Obrador pursued redistributive policies of precisely the kind that he would advocate as a presidential candidate, cementing the credibility of the PRD’s redistributionist promises.⁹³ As president, Vicente Fox pushed through measures such as the Information Access Law and a civil service reform that strengthened the PAN’s reputation as a pro-democracy party with managerial competence.

5.28 Therefore, by 2006, both the PRD and PAN were easily identified by voters as parties of the left and right – as parties more or less likely to favor state intervention to promote economic development, or more or less likely to give redistribution a central

⁹² In its concern about presenting a coherent policy profile to voters, the PAN also refused to “massify” its party base (Langston 2003).

⁹³ For example, of the “50 Compromisos Para Recuperar el Orgullo Nacional” on the PRD website, the second one is “As was done in the Distrito Federal, we will establish the right to a subsistence pension (*pensión alimentaria*) for all adults more than 70 years old.”

role in promoting equality. This made it easy for them to attract left- or right-leaning independent voters in 2006.⁹⁴

5.29 The PRI, in contrast, projected a less clear ideological stance before the electorate, and correspondingly attracted voters who were themselves ambivalent in their ideological convictions. Survey data show less stability in the self-identification of PRI voters than of PAN voters over the same four months; .72 versus .87 for February to June-July; or for February to May-June, .81 vs .89 (McCann and Lawson 2003).⁹⁵ There is also evidence that the PRI relied more on clientelistic appeals. Of 1260 respondents in the above-mentioned survey, 14.7 percent (185) reported that they had received gifts from political parties or campaigns. More than half of these, (111 respondents) also declared that they were PRI sympathizers (Cornelius 2002).⁹⁶

5.30 In sum, by 2006 some of the basic conditions were in place so that electoral contest would increasingly be about policy alternatives. Two of the three main parties, PAN and PRD, seem to have established clear presence in voters' minds with respect to their contrasting policy stances. Nevertheless, as discussed in the following section there are areas of reform that can solidify this progress, and lift remaining constraints to effective electoral accountability both on the side of the politicians/political parties ("supply" side) and the voters ("demand" side).

The Reform Agenda: Strengthening the Policy Reputations of Political Parties

5.31 A key issue in building policy reputations for parties, an essential ingredient of electoral accountability, is to ensure (i) that the parties draw their support from a relatively broad constituency, especially in terms of geographic coverage (so that they would address issues of national concern rather than parochial interests of particular regions);⁹⁷ and (ii) that members of the party share the policy preferences espoused by

⁹⁴ The PRI has been at a disadvantage in this regard. Although it was historically and rhetorically strongly rooted in leftist ideology, as a dominant ("catch-all") party that drew votes from all spectrums of voters, its ideological "label" was always somewhat ambiguous. The collaboration with the PAN during the 1980s and 1990s on a variety of market-oriented reforms added to this ambiguity by sending confusing messages to voters as to where the PRI as a party stood on key economic issues. Deep internal party divisions emerged precisely between these two ideological poles. This is evident in the declining representation of PRI-affiliated workers' groups in the Congress, who were most opposed to the liberalizing policies of the 1980s. Their share of seats fell from 30 during the 1982-1985 electoral cycle to 11 in the 1988-1991 period (Langston 2005 p. 12).

⁹⁵ The PRD was also more stable from February to May-June (.88), but matched the PRI over the longer period (.72).

⁹⁶ This could be because the PRI has a more efficient party machine, better able to distribute targeted pre-electoral benefits. It is also not clear from his analysis, however, who gave the gifts nor what percentage of respondents declared themselves PRI sympathizers. If less than half of the total were PRI sympathizers, however, his evidence at least demonstrates that PRI sympathizers were more likely to receive gifts from some party.

⁹⁷ The coherence and credibility of parties with respect to their policy positions is central for electoral accountability. This depends on the quality of the parties' policy proposals as well as on the degree to

the party and the party leadership is able to discipline the members (rather than being dominated by individual “loose cannons” with their own support base using the party label for convenience).⁹⁸

5.32 In terms of geographic coverage, Mexico’s major parties, except the PRI which has maintained national presence, tend to draw disproportionate shares of their votes from specific regions, as clearly demonstrated in the last presidential election. The PAN and the PRD have national-level recognitions, and are apparently gaining their presence in many parts of the country. However, if their positions solidify in their respective geographic strongholds, this pattern could harm electoral accountability to the extent they represent “parochial” regional interests. This issue will be reviewed in the next section.

5.33 Another critical variable is the degree to which the parties are united behind their announced policy preferences, or party discipline. In the case of the democratic Mexico, the presence of term limits now hurts party discipline by preventing parties from denying future nominations to politicians who deviate from the party line.⁹⁹ In a hotly competitive political environment with no immediate reelection, parties are not able to reward loyal politicians with re-nomination to their current office, but instead parties must nominate them for another elected office, which is by definition riskier and frequently less valuable. Alternatively, parties need to offer them a position in a future government, which unlike in the days of the PRI hegemony, is far from guaranteed and, therefore, also less valuable. Moreover, one effect of implementing term limits under the PRI – denying politicians the ability to develop personal constituencies – is now less of an attraction for parties. While parties want to preserve their programmatic appeal to voters and avoid politicians who are at odds with their program, their ability to win

which the parties are united behind their announced policy preferences. The quality of policy proposals, especially when parties are in opposition, can be enhanced if parties themselves can rely on well-regarded policy analysis capabilities. This is often obtained through reputable think tanks (or foundations) associated with the parties. But it is not the mere presence of such think tanks but the quality and credibility of their analytical outputs that matters. Many parties in Latin America are supported by think tanks of sorts that are directly or closely associated with them, but the quality of their outputs and the extent to which they are recognized as credible sources of policy proposals varies considerably across countries (Jones 2005).

⁹⁸ IDB (2006) argues that three key characteristics of party systems that affect their role in policymaking are (i) the degree to which the parties are institutionalized; (ii) the degree to which party system is fragmented; and (iii) the degree to which parties have national, as opposed to regional, presence.

⁹⁹ When the PRI controlled all branches of government and had every prospect of maintaining control into the future, term limits ironically served to increase party discipline. On the one hand, individual party members could not develop personal constituencies that would give them independence from the party leadership and, potentially, the ability to split off from and compete with the PRI. On the other, since the PRI controlled all the offices, at both national and state levels, and as long as its electoral hegemony was unchallenged, it could dangle future offices to term-limited officials as a reward for their loyalty.

votes with programmatically-aligned candidates is greater to the extent that those candidates have personal constituencies.¹⁰⁰

5.34 These considerations lead to the option of relaxing or even eliminating term limits for elected representatives. Lifting the current rule that prohibits immediate reelections of legislators would bring about other benefits, such as the greater likelihood of legislative professionalization. As our analysis shows, political parties are beginning to be more active in the legislative arena as originators of bills. At the same time, the case of the stalled debate on the comprehensive public security reform has partially been blamed on the lack of technical expertise in Congress.¹⁰¹ This implies that greater professionalization of the political parties and of the legislators is acquiring added values. Further investing in the political parties' and individual legislators' policy-making capacities could contribute to ensuring that the larger quantity of legislative activities by the parties is accompanied by better quality of their proposals.

5.35 Apart from lifting the immediate no-reelection rule, it may be prudent not to embark on other electoral system reforms at this stage. As we argued in Chapter 4, behavioral effects of institutional reengineering are not always predictable, and any particular change would involve trade-offs. For example, one of the proposals being debated is to increase the number of legislators elected on a US-style single-member district formula, presumably to increase legislators' responsiveness to their local constituents rather than to their parties' leadership. Given the perceived lack of responsiveness displayed by the PRI for decades, this concern is fully understandable. However, a single-member district formula could have the effect of weakening party discipline, if the candidates manage to cultivate personal appeals in their constituencies. In some districts, these appeals could be developed on the basis of clientelistic exchanges between the voters and the candidates.

5.36 The alternative formula, proportional representation, has the opposite quality. It tends to strengthen party discipline, but sometimes at the expense of responsiveness of individual politicians to specific constituencies. Neither formula has distinct advantage over the other in terms of its propensity to withstand special interests' influence. Therefore, a challenge for Mexico at this point seems to be one of a balancing act between party discipline and coherence of parties' policy proposals on the one hand,

¹⁰⁰ The evidence that term limits reduce party discipline is nowhere better demonstrated than with the PRI itself. Weldon (no date) presents evidence concluding that the PRI went from the most to the least disciplined party from 1998-2000 to 2000-2002. This is easily explained by its loss of hegemony and the capacity to reward party loyalists. The fact that the PRI is the least programmatic party exacerbated this effect – the potential loss of the party label, should a PRI legislator leave the party, means less to the PRI candidate than to candidates of other parties.

¹⁰¹ An alternative hypothesis offered is that the political parties did not act on the government bill in order to prevent the government from taking credit for such an important initiative. Rivalry between the federal and the DF governments over public security matters that was displayed during the tenure of the Fox and the Lopez Obrador administrations gives some credence to this hypothesis. Our field research was not able to explore which of these two hypotheses, or another explanation, fit the situation best.

and their responsiveness to voters on the other. The current electoral formula that mixes the single-member-district approach and the proportionality approach may be a reasonable compromise in this sense. Given the evolving political situations, including possible re-alignment of voters around the PAN and the PRD (with the PRI apparently becoming a minority “centrist” party in-between), it would seem advisable to refrain from what may turn out to be a premature experimentation with electoral institutional designs. Instead, the focus should be on letting this evolving process mature, trying to ensure that inter-party competition centers around substantive policy debates and making governance of the political parties more transparent and democratic.

5.37 The other political reforms being discussed, such as a change to a parliamentary system or a creation of a new post of prime minister, by themselves are not going to have any significant effect on voter-politician relations. Given the analysis presented, the position of this report is that such reforms may not be as important as those intended to strengthen effects of electoral accountability.

Poverty and Social Polarization as Obstacles to Electoral Accountability

5.38 Social and political polarization has come to be highlighted as a distinct characteristic of Mexico today. Polarization reduces trust, such that richer voters do not believe that policies of the party of the “poor” will benefit them, and vice versa. For example, evidence suggests that the poor majority in Mexico would be better off if labor regulations were relaxed or VAT exemptions were lifted and public spending for the poor were increased (which would imply tax increases). In polarized societies, however, the poor are less likely to believe these policy promises unless they are made by a party of the poor. A pro-growth party has a more difficult time convincing the poor in a polarized society that growth is likely to raise their incomes more than redistribution because the poor do not believe that the pro-growth party will implement its policies in a way that will benefit them. At the same time, evidence suggests as well that greater investment in public education would have a substantial growth payoff. However, the less poor in a polarized society are less likely to believe promises of a party of the poor that increased spending on education will lead to increased learning. A pro-poor party, in contrast, has a more difficult time convincing richer voters in a polarized society that it will not implement pro-poor policies at the expense of growth.

5.39 Poverty constitutes another barrier to electoral accountability as it renders policy-based appeals less compelling than clientelistic or populist appeals.¹⁰² Education

¹⁰²Dixit and Londregan (1996), developing the implications of the observation that 100 pesos improves the welfare of a poor person more than that of a rich person, conclude that clientelistic appeals are most effective with poor voters. Keefer and Vlaicu (2005) show as well that when clientelism is a more cost-effective way of gaining voter support, as when voters are poorer, politicians are reluctant to invest in improving their reputation across the entire electorate for supporting improved public good provision that benefits the whole electorate. Data supports the idea that programmatic parties are less likely in poorer democracies. The Database of Political Institutions (Beck, et al. 2001) records whether countries can be

also affects the desirability of electoral appeals based on policy proposals. Poverty and poor education, of course, tend to go hand in hand and reinforce each other. Sophisticated voter calculations and good knowledge of the policy making process are needed for voters to give parties credit for improving public good provision, such as higher quality education. In contrast, even unsophisticated voters can easily give credit to politicians for the provision of targeted transfers, local school buildings or jobs in government. Clientelistic appeals should therefore be more attractive with less educated voters. Again, there is evidence of this in Mexico. Voter identification with the more policy-oriented PAN and PRD was more stable among more educated voters (McCann and Lawson 2003). The reverse was true for the PRI, however: among less-educated voters, the correlation of PRI party identification in February with PRI identification in June was .82 compared to .74 for more educated voters. The instability of the policy orientation of the PRI is also evident in the shift among PRI supporters from an anti-redistributionist stance to a more centrist position in 1997.

5.40 If poor voters are spread evenly across electoral districts, parties may still prefer to make programmatic appeals, since this is the most effective way to reach the non-poor voters. However, when poor voters are geographically concentrated, this is no longer the case, particularly when the electoral districts are more sparsely populated, because clientelistic promises are much easier to make and honor when the beneficiaries are fewer in number. This is precisely the case in Mexico: it is well-known that Mexico exhibits significant spatial inequality, such that a significant fraction of Mexican states are substantially poorer than other states; many of these are also more sparsely populated.

5.41 The richest state/federal entity in Mexico is the Distrito Federal (with per capita income in 2004 of 172,527 pesos) and the poorest is Chiapas (27,099 pesos), a ratio of 5.9 to one. If one takes the second richest and second poorest states (Nuevo Leon and Oaxaca), the ratio is 123,853 pesos to 28,703 pesos, or 4.3. In contrast, the United States, not famous for its income equality, the richest state/federal entity is Washington, DC and the poorest is Mississippi: the ratio of average income between the two was 2.1 in 2004, one-third the corresponding ratio in Mexico. The difference between the second richest state, Connecticut, and the second poorest state, Arkansas, was 1.8, less than one half of the corresponding Mexican ratio. And in Mexico, of the 20 states with incomes per capita less than the national average, ten have populations less than the median state

categorized as economically right, left or center, or as none of these. In 2000, 72 percent of the parties in 46 poorer countries with competitive elections could be placed in one of these categories, one standard deviation less than the 92 percent in 48 richer countries. The time a party has competed under a particular name is another approximation to its broad credibility. The DPI reports that the average number of years that a party has existed under its current name in rich democracies is twice that in poorer, 47 years versus 23.

population: that is, electoral competition in 10 of 32 federal entities (31 states and the DF) is particularly vulnerable to strategies based on clientelistic appeals to voters.¹⁰³

5.42 There is also some evidence of the bifurcation of political strategies in Mexico across richer and poorer districts. In her review of candidate strategies, Langston (2005) concludes that “. . . candidates can now be distinguished more by the type of district they campaign in than by the party label they sport: deputy hopefuls in competed districts are more likely to use more modern appeals at the same time they reach out directly to the voters via personal contact. Electioneering in rural, non-competed districts is strikingly similar to the old-fashioned campaigns of the 1970s and 1980s, with the proviso that mass rallies have become less popular” (p. 27). “Old-fashioned campaigns” include focusing on clientelistic promises, such as the candidates’ ability to act as intermediaries so that weak constituents could gain access to local services (p. 14).¹⁰⁴

5.43 However, perhaps more important than the effect of these spatial and income gaps on state-level party strategies is their effect on polarization. Rich and poor states separated by long distances, as in Mexico, constitute a breeding ground for social polarization. Survey results show that only 5.4 percent of poor Mexicans responded positively to the question “How often do different people have their rights respected in practice?” compared to more than 18 percent in Central America and in Latin America as a whole (PNUD 2004, p. 259).¹⁰⁵ The trust gap between the parties is partially illustrated by the earlier discussion of tax reform. The PAN argued, with reasonable analytical support, that every peso of benefit that the poor received from VAT food exemptions was matched by four pesos of benefit to the rich. It promised to spend revenues saved from abolishing these exemptions on the poor, but these promises were apparently not credible as 46 percent of survey respondents in 2003 did not believe the president’s claim that reform would be good for Mexico, and instead 51 percent of respondents surveyed in 2001 judged the 2001 tax reform to be “unjust” (Lehoucq 2006). Lack of credibility of political promises is a crucial barrier to the efficacy of democratic decision making as it undermines accountability of politicians in the electoral process.

¹⁰³ Mexican data from INEGI, *Sistema de Cuentas Nacionales de Mexico* 2004, and the *Censo Nacional*, 2000. Information for the United States from the US Bureau of Census.

¹⁰⁴ If poor voters are concentrated, a smaller fraction of legislators represents the interests of the poor. This is easy to see. Assume there are three legislative districts, each with 100 voters, either poor or rich. In scenario 1, district 1 has 100 poor voters, district 2 has 40 poor voters and district 3 has 40 poor voters. In this case, two of three legislators will be most responsive to rich voters, opposing a redistributive agenda although poor voters are the majority overall. In scenario 2, the same number of poor voters is distributed evenly across all districts (60 in each). In this case, legislators in all three districts favor the poor and agree on a redistributive agenda.

¹⁰⁵ Polarization can undermine support for democracy itself. Although there is no data for Mexico, this is evident in Perú, a country traditionally considered deeply polarized according to income, geography and ethnicity. In surveys commissioned by the UN Development Program, respondents in Lima expressed fifty percent greater support for democracy than those in outlying areas (PNUD 2006, p. 33).

5.44 There is an indication, at least an indirect one, that the recent pattern of the evolution of the Mexican economy, including the differential effects of NAFTA and associated reforms across sectors and geographic regions may be fueling this political divide. Tellingly, the geographic distribution of the “NAFTA dividend” closely mirrors the voting pattern in the 2006 presidential election. According to the results of the exit poll published in the *Reforma* newspaper,¹⁰⁶ the regions that have benefited from NAFTA tended to support the PAN candidate (43 percent and 47 percent of votes from the North and the Center-West regions, respectively, went to Felipe Calderón), whereas the regions that fared worse were more inclined to support the PRD candidate, Andrés Manuel López Obrador who drew 44 percent of the Center region’s votes (having been the relatively successful mayor of the Federal District) and 40 percent of the South’s. The voters’ assessments of the economic situations also influenced their choice of candidates in a similar way. Thus, 60 percent of those who felt the economic situation had improved supported Calderón, whereas 52 percent of those who felt the situation had worsened and 40 percent of those who did not note any change favored López Obrador.¹⁰⁷

Table 5.1 Vote Share of Major Presidential Candidate by Voters’ Region and View of the Economy, 2006 (%)

Region	Felipe Calderón (PAN)	Roberto Madrazo (PRI)	Andrés Manuel López Obrador (PRD)
North	43	27	24
Center-West	47	20	27
Center	34	15	44
South	27	29	40
View of economy			
Improved	60	15	20
Same	30	24	40
Worsened	12	31	52

Source: Exit poll by *Reforma* newspaper.

5.45 Evidence of income-based polarization is more subtle. According to the *Reforma* data, the extent to which the PAN candidate drew his votes from the upper-income groups and the PRD candidate from the lower-income group does not offer as stark a contrast as the case of the regional voting pattern. The two candidates’ shares of votes from each income group are relatively similar except among the richest group, 50

¹⁰⁶ July 2, 2006.

¹⁰⁷ These superficial observations of poll data should be taken with extreme caution. It is possible that what social science methodologists call ecological fallacy may result from associating two different polling results at the aggregate level. It is possible, for example, that many of those who felt the economy was doing worse actually resided in the region, such as the North, which on average has done better than other regions.

percent of whom supported Calderón as opposed to only 30 percent support for López Obrador.

Table 5.2 **Vote Share of Major Presidential Candidate by Voters' Income Level, 2006 (%)**

Income level	Felipe Calderón (PAN)	Roberto Madrazo (PRI)	Andrés Manuel López Obrador (PRD)
Less than \$2,000	31	30	34
\$2,000-\$3,999	32	24	39
\$4,000-\$6,499	36	21	37
\$6,500-\$9,199	43	16	36
\$9,200 or more	50	14	30

Source: Exit poll by *Reforma* newspaper.

Reforms to Moderate the Political Effects of Poverty and Polarization

5.46 Given the distrust social polarization generates, the key issue for reform is how to use public policies and institutions in a way that builds trust, while simultaneously addressing the causes of the social divide. In this sense, more than ever, there is a large scope for strengthening independent public institutions ranging from the judiciary (already quite independent) to the civil service to specific regulatory agencies. Mexico's political progress has been possible to a large extent thanks to the political independence and the technical competence of the institutions that regulate electoral processes, and in this sense, guarding independence of the Federal Electoral Institute and the Federal Electoral Court should be a high priority to ensure integrity of future electoral processes. No additional action may be necessary since these institutions are already independent, but it does not take much to undermine formal independence of public institutions in a politicized environment. Hence the importance of protecting the independence by maintaining the tacit agreement among the major political actors to keep these institutions "off limits" to day-to-day political contest. Given the uneven levels of institutional development of state-level electoral institutions, promoting independence and technical competence of these institutions should also be a high priority.

5.47 Of course, institutional independence does not emerge in a political vacuum. All public institutions are creations of politics in one way or another, and the same political forces that undermine electoral accountability and exploit social polarization might also compromise de facto autonomy of formally independent public institutions. Some argue, nonetheless, that when competing political forces are more or less evenly matched in their access to power, there is a greater incentive to cooperate and leave increasingly larger parts of the state in politically neutral hands (e.g., professional civil servants, independent commissions), although in today's charged political environment,

such a possibility may seem distant.¹⁰⁸ It would thus be imperative that the new government work with opposition parties to strengthen independent institutions and provide them with sufficient financial and human resources so as to assure their competence, and thus credibility.

5.48 Given their importance in promoting a more competitive economy and their role in resolving conflicts among economic agents, regulatory institutions, specifically, are an important area to consider; if they are not regarded as independent and professional, political agreements that rely on regulatory institutions for implementation will not be credible and will not be signed. Regulatory independence is not essential to regulatory performance and in no country is every regulator fully autonomous of the government. Nevertheless, as discussed in Chapter 3, there is ample scope for strengthening statutory (as well as de facto) independence of Mexico's regulatory entities, most of which lack formal autonomy commonly granted to modern regulatory institutions. Besides the IFE and the Mexican Central Bank, all other regulatory bodies in Mexico are either decentralized or de-concentrated agencies without full statutory independence. While decentralized bodies can have their own resources, which in turn provide them with higher levels of independence from the executive, they have no enforcement authority, hence limiting their ability for effective regulation. In contrast, de-concentrated bodies cannot have their own resources, but have enforcement authority. Mexico would benefit from establishing truly autonomous regulatory bodies for which both economic independence and the ability to enforce their decisions need to be ensured.

5.49 The Fox administration made some progress in reducing regulatory burdens on the private sector (World Bank 2006c). In the context of polarization and mistrust, it might be opportune for the current PAN administration, which is seen as business friendly, to deepen regulatory reforms with the explicit aim of establishing formal independence and tighter regulation of anti-competitive behavior. Because a main purpose of granting statutory autonomy to regulatory agencies is to give assurances to all that they are independent of short-term political interests of the government in power and of the business sector that they regulate, it is equally important to make sure their decisions and criteria for those decisions are publicly disclosed rather than veiled behind the curtain of technocratic insulation.

5.50 To the extent the current political polarization has been fueled by either the perception or the reality of unequal distribution of the benefits of the past economic reforms, it will also be necessary to redress this situation over the medium to long run. It will not be an easy task because any hint of re-distribution, which such a policy could possibly entail, would face resistance from those who have less to complain of the existing arrangement. An expansion of the successful *Oportunidades* program would be an obvious choice, but that is unlikely to be sufficient to make less developed regions (especially the poorer south) be able to insert themselves in the globalized economy and

¹⁰⁸ See, for example, Geddes (1991).

be competitive. A more aggressive approach, such as a policy of regional fiscal compensation and centrally-funded support for infrastructure investments in less developed regions (e.g. similar to the European Union's support for less developed member states), would require additional fiscal revenues, and possibly an adjustment to the current fiscal federalism arrangement.

5.51 Mitigating clientelism-inducing effects of poverty will be just as challenging. In the long run, solutions will be found in achieving better education and raising income levels so that the voters are better equipped to cast their votes based on a good understanding of policy implications and are less vulnerable to particularistic promises of politicians. In the short run, the most promising approach may be to strengthen civil society oversight of delivery of those particularistic goods that politicians have promised. Well-organized non-governmental groups could provide technical support for communities to inspect, for example, whether specific public works are carried out in a technically sound manner. Such an activity will not necessarily create political pressure for less particularistic policy responses, but they could still serve as a means of ensuring a degree of accountability by politicians to the community.

SUMMARY

5.52 All of the foregoing analysis has asked why increased electoral competitiveness in Mexico has not led to more striking policy changes. Democracy leads to better, more "public-regarding" policies by allowing citizens to express their interests through the electoral process. To the extent that the electoral competition takes place on the basis of programmatic policy appeals by political parties, elections can provide voters with concrete choices of a set of policies as a basis for their voting decisions, and enable them to hold the incumbent government (or party in the case of Mexico given the no-reelection rule) for its performance. Mexico enjoys an important advantage in this regard over most of its neighboring countries.

5.53 However, the effects of the competitive elections in Mexico seem to be dampened by a series of countervailing factors that limit the political parties' incentives to seek votes on the basis of their programmatic reputations. The challenges of improving the quality of democratic governance in Mexico are considerable. Addressing them will take time. But this is only to be expected given the relatively young age of Mexico's democracy. Dramatic improvements are unlikely over a short period of time, although certain specific steps to weaken the influence of extra-institutional pressures on policy making could have immediate effects on reform progress.

5.54 In this final chapter, we offered a small number of priority areas for attention from the point of view of strengthening Mexico's burgeoning democratic governance. The driving concern is to strengthen electoral accountability in Mexican politics so as to restrain the pervasive influence of special interest groups. We suggest that special interests' influence could be controlled with transparency measures that allow the

general public to scrutinize their political behavior. Ultimately, however, relevant sectoral reforms, such as deepening of education decentralization or reduction in market concentration, would be necessary to disperse the political power currently concentrated in few hands.

5.55 A complementary set of reforms would be needed to strengthen electoral accountability of politicians. Here we advocate measures to encourage policy-based competition among well-institutionalized political parties as an ideal situation. For this, our suggestion is to consider lifting the electoral rule so peculiar to Mexico that prohibits legislators from running for immediate reelection. Our review of the evidence does not give us a reason to propose (or reject) a similar reform to the reelection of elected executives, including the president. It might be worthwhile experimenting with effects of executive reelections at the state level by allowing individual states to decide on this issue on their own. Possible benefits of executive reelections are expected to be higher at the municipal level where the current three-year term of the municipal presidents is probably too short for effective governance. Other possible reforms to the electoral system, such as to change the current mixed system to a single-member district system or to a proportional representation system, seem unlikely to effectuate desired results, that is, to encourage policy-based competition among well-institutionalized political parties. Since institutional reengineering is politically taxing and its outcomes are uncertain, it seems prudent not to embark on that path, at least for now. Hopefully, the above-mentioned transparency measures would also contribute, at least indirectly, to substantive policy debates as part of the political contest among political parties.

5.56 Policy-based electoral competition faces various obstacles in Mexico besides the legislators' short-term orientation because of the prohibition of reelection. These additional obstacles include poverty that tends to breed clientelism, and socioeconomic divide that has apparently translated into political polarization, which in turn weakens credibility of politicians. The best remedy against clientelism is policy-based party competition discussed above in the short run. In the long run, the reduction of poverty is expected to reduce, if not eliminate, sources of clientelism.

5.57 Addressing polarization, however, seems to be a different challenge and perhaps a higher priority in the short run. No amount of policy proposal will be taken as credible or sincere if the environment is so polarized and mistrust reigns. The government could take measures to build credibility among those voters who sit on the opposite camp of the polarized political map. One set of options would be to launch a visible program to strengthen statutory autonomy of a range of government institutions such as the civil service and to ensure independence and impartiality of existing autonomous bodies such as the IFE.

5.58 For several reasons, granting independence to regulatory agencies within transparent public accountability arrangements might be a fitting entry point. If successful, such reforms could also contribute to the country's competitiveness agenda,

and, especially for the incoming administration that is seen as business friendly, would send the signal to the population in general that the government is not captured by powerful business interests.

5.59 An ultimate objective of these efforts would be to develop a strong perception, as well as reality, of transparent, rule-based governance, or the rule of law, as a long-term substitute for the informal and highly discretionary style of governance that characterized the long reign of the single-party hegemony. With the strong rule of law in place, citizen confidence in the State can be restored, and politicians' credibility can be enhanced, both of which are essential conditions for electoral accountability, which in turn forms a basis of effective democratic governance.

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