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The Second Mexican Revolution: Economic, Political, and Social Change Since 1980

This book is about a revolution – albeit an incomplete one. It had none of the features that political analysts typically associate with revolutions: no organized violence, no overturning of the social class structure, and no defeated dictator fleeing into exile. Nevertheless, if by "revolution" we mean a dramatic change in the institutions that organize economic, political, and social life, then Mexico has undoubtedly been in the midst of a revolution since the early 1980s.

In 1980, Mexico was largely closed to foreign trade and investment; government-owned firms controlled a substantial portion of the economy. An "official" party, the Institutional Revolutionary Party (PRI),[1] held a virtual monopoly on political power. Since its creation in 1929, Mexico's government-supported party had won every presidential, gubernatorial, and senatorial election. To maintain a façade of democracy, PRI-led administrations crafted a complex set of electoral rules that allowed other parties, some of which were actually subsidized by the government, to win seats in the federal Chamber of Deputies (Mexico's lower house of congress). The PRI, however, always dominated this chamber by an overwhelming majority. The PRI used its electoral dominance to maintain control over Mexico's regulatory and legal systems: PRI-affiliated government officials named state and federal judges and the directors of government-owned firms as well as making appointments in the federal bureaucracy. So complete was the political hegemony of the PRI that many of its opponents, as well as

[1] Many of the acronyms that appear in the text refer to an organization's Spanish-language name. See the List of Acronyms for complete names and their English translation.

many foreign observers, accepted without question the way that the PRI framed the challenges and proposed solutions to Mexico's development problems: the assumption that "market failures" required active state intervention in economic affairs, the conviction that extensive restrictions on foreign trade and investment were necessary for economic development, and the belief that the successful defense of national sovereignty required that political power be concentrated in the federal executive and an "official" party.

Less than three decades later, Mexico is a multiparty democracy in which the PRI holds a minority of seats in the federal Congress. In fact, the country's two most recent presidents, Vicente Fox Quesada (2000–2006) and Felipe Calderón Hinojosa (2006–2012), have come from the opposition National Action Party (PAN). In addition, the Mexican economy is now open, and goods and capital move freely in and out of the country. The vast majority of state-owned firms have been privatized.

Mexico's political and economic transformations have not, however, been uniform or entirely successful. Mexico has become more democratic in terms of electoral competition and freedom of expression in the mass media, but the rule of law has not been consolidated. Indeed, in a number of states the governor still appoints the members of electoral tribunals and state court judges, who in turn often make rulings based on partisan grounds. Mexico's police forces remain notoriously corrupt. Property rights are vaguely defined and costly to enforce.

Although Mexico is now open to foreign trade and investment, and exports have boomed, these changes have not produced rapid, sustained economic growth. Whether we date Mexico's opening up to trade and investment from 1986, when Mexico joined the General Agreement on Tariffs and Trade, or 1994, when the North American Free Trade Agreement went into effect, the results are the same: Real (inflation-adjusted) per capita growth in Mexico between either date and 2005 averaged 1.3 percent per year – a slow rate by any comparative standard. It was 38 percent slower than the growth rate over the same period for comparable, middle-income developing countries (2.1 percent per year), 43 percent slower than the U.S. growth rate (2.3 percent per year), and 54 percent slower than Mexico's own growth rate from 1950 to 1980 (2.8 percent per year).[2] It was, moreover, slow

[2] Chapter Two develops these comparisons in more detail. See that discussion for the data sources for these calculations.

compared with the growth rate that would have been needed to provide employment for the roughly 1 million individuals who enter Mexico's labor market each year. More than half of these new workers do not find employment in Mexico; instead, they migrate to the United States.

In this book we examine the nature and causes of the momentous economic, political, and social transformations that Mexico has experienced since the early 1980s.[3] We particularly seek to understand why Mexico has had an incomplete "second revolution." Why did the opening up of the economy to foreign trade and investment not result in more rapid economic growth? Why has electoral democracy not produced rule of law? What are the principal challenges that Mexico must address to achieve such widely shared goals as sustained economic growth, effective democratic governance, and the rule of law?

Providing answers to questions such as these requires both facts and a conceptual framework that can organize those facts into a coherent explanation. In the pages that follow, we outline and contrast the political and economic logics of authoritarian and democratic regimes. Among other significant differences, authoritarian and democratic political institutions imply substantially different systems of property rights and taxation, and they produce as outcomes dramatically different levels of public investment and economic growth. In subsequent chapters we show how this framework helps make sense of Mexico's development experience both before and after its democratic opening, and we draw on this analytical approach to identify several of the most salient public policy challenges facing Mexico in the early twenty-first century.

The key point we wish to make is this: Some of the institutions that emerged during Mexico's prolonged period of authoritarian rule, such as those governing the certification of elections, can be swept away with the stroke of a pen; other institutional arrangements, however, are extremely difficult to reform and thus can persist well after a country has democratized. Pro-democracy forces struggled hard for many years to ensure free and fair elections, but the reforms enacted in 1996 that made the Federal Electoral Institute (IFE) fully autonomous

[3] We do not, however, pretend to offer a comprehensive account of the Mexican experience during this period. A number of important issues – ranging from significant changes in foreign policy (especially Mexico's relations with the United States) to the multiple problems posed by powerful drug-trafficking cartels to emerging environmental challenges – therefore remain outside the scope of our analysis.

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and nonpartisan marked a clear break with decades of electoral manipulation and fraud. Yet other legacies of authoritarianism – including the weak rule of law, costly enforcement of property rights, and low taxation on capital – persist and continue to weigh heavily on Mexico. Reforming the legal and property-rights systems requires, at a minimum, reforming the tax system because honest judges and police forces and accurate property registers all come at considerable fiscal expense. Individuals and firms without substantial financial resources or political influence can only enforce contracts at very high costs, limiting economic growth and social mobility. Low taxation prevents the government from investing in physical infrastructure (roads, bridges, sewerage systems, and so forth), education, public health, and social insurance, which not only reduces the quality of life but also lowers the long-term rate of economic growth. Citizens find it difficult to secure their basic rights as long as they remain subject to extortion by corrupt police and venal public officials.

The Political Economy of Authoritarianism and Democracy

How political power is distributed marks the fundamental difference between authoritarian and democratic regimes. In authoritarian regimes, power is concentrated in the hands of a small elite group and is often exercised arbitrarily. Authoritarian rule may take many different forms, ranging from highly personalistic autocracies, to military juntas, to regimes dominated by either single or hegemonic parties.[4] In all these cases, however, governing elites typically combine repression, cooptation, and ideological justifications of their claim to rule to marginalize opponents and maintain tight political control.

Democratic regimes also vary significantly in their specific organizational arrangements and political practices (presidential versus parliamentary systems, for example). Yet all these regimes are based on the guarantee of clearly defined citizenship rights (including freedoms of expression and association, and especially protection against arbitrary state action), frequently scheduled and fairly conducted elections in which all citizens are free to participate (universal suffrage) in the selection of representatives who will exercise public authority, and

[4] On postrevolutionary authoritarian regimes and the Mexican case, see Middlebrook (1995), Chapter 1.

established procedures to ensure that citizens can, through the rule of law, hold elected officials accountable for their public actions. In a democracy, then, political power is dispersed among different branches and levels of government and its exercise is constrained both in law and in practice.

These contrasting regime characteristics have broad implications. To illustrate these differences more fully, this portion of our discussion highlights major themes from the emerging literature on property-rights regimes. We take this approach in part because the generation of wealth and its distribution are core concerns in capitalist democracies, as well as because economic issues such as investment and taxation have been so central to debates in Mexico about the country's development options. Our main purpose in adopting this particular analytical perspective, however, is to underscore the sharply contrasting internal logics of authoritarianism and democracy. In later chapters, we draw on this framework to illuminate the coalitional dynamics that have shaped major economic and social policy outcomes in Mexico since the late nineteenth century.

Whether under authoritarianism or democracy, individuals engaged in economic transactions and a wide range of other activities require an entity that can arbitrate contracts and enforce "property rights," broadly defined. In numerically small, geographically limited, and socially homogeneous societies, a variety of actors might perform this role satisfactorily. Once societies become large and heterogeneous, however, the only entity that can effectively arbitrate property rights is the government. This creates a dilemma: Any government powerful enough to define and adjudicate property rights is also strong enough to abrogate them for its own benefit. Unless the government can give the population credible reasons to believe that it will not act arbitrarily in its own short-run interest (for example, by seizing property or taxing away all of the income it produces), the population will not invest or engage in a wide range of other productive activities. If there is no investment, there will be limited economic activity, and hence there will be little for the government to tax. The result is a paradox: Unless institutions are created that limit the authority and discretion of government, the economy will not grow, and the government itself will have insufficient revenues to ensure its own political survival.[5]

[5] The problem of credible commitment is as old as government itself. Its first modern articulation can be found in James Madison's writings in the Federalist Papers. In the modern social science literature, the commitment problem reemerged in Schelling (1956, 1960). Schelling convincingly argued that a party that is unable to bind itself to a commitment is

Liberal Democracy as a Solution to the Commitment Problem

The most efficient solution to the problem of credible commitment is liberal democracy. A liberal democracy is composed of sets of mutually reinforcing institutions that constrain the government and safeguard citizens against the arbitrary abuse of state power. We tend to think of liberal democracies as being characterized first and foremost by electoral competition for public office, but elections are only one of a number of institutional arrangements that limit governmental actions and protect citizen rights. The reason is simple: Elections only occur periodically, after which politicians have opportunities to abuse their power.[6] At a bare minimum, preventing that abuse requires a number of other institutions, including a representative legislature, an independent judiciary, competitive political parties, a free press, and a professionalized civil service.

As we have noted, the exact configuration of political institutions varies from one liberal democracy to the next. Nevertheless, all democracies feature institutional arrangements that accomplish three goals. First, democracies have institutions that create "veto points" in the decision-making process, thereby limiting the discretion of any individual actor within the government. In the United States, for example, no single actor in the central government can create law. Instead, laws must be approved by two separate legislative bodies (the House of Representatives and the Senate), as well as by the president. Even then, they are subject to judicial review by the courts.

Second, liberal democracies have institutions that allow citizens, as well as actors within the government, to sanction public officials who exceed their authority. These sanctioning mechanisms include the ability of citizens to vote legislators and heads of government out of office, as well as such procedures as impeachment, recall initiatives, and the use of the judiciary to prosecute malfeasance in office.

Finally, democracies characteristically have institutional arrangements that generate incentives for different actors and bodies within

prevented from entering into an effective agreement with another party – and, therefore, is impelled to construct and/or adopt pre-commitment devices. North (1981, 1990) built on this problem in his neo-classical theory of the state. There now exists a broad literature on various problems related to credible commitment. For a sampling of relevant works, see North and Weingast (1989); Shepsle (1991); Weingast (1995, 1997); North, Summerhill, and Weingast (2000); Bates (2001); and Haber, Razo, and Maurer (2003).

[6] Persson, Roland, and Tabellini (1997).

the government to veto and sanction one another. Typically, these incentives stem from the existence of multiple political parties locked in competition with one another for power.

These core institutional features of liberal democracy have significant implications for the exercise of power. For instance, governments cannot act in an arbitrary manner against wealth holders. They may, of course, raise taxes or confiscate property in the public interest, but to do so they must navigate past multiple veto points in the decision-making process (for example, judicial appeals of laws that deprive citizens of their property without due legal process). These veto points may, of course, allow wealth holders to have influence beyond their numbers – especially if wealth holders can join a coalition that allows them to trade support of private property rights for their support of some other policy issue.[7]

Precisely because the government cannot act arbitrarily, wealth holders do not fear that the government will prey upon them by expropriating their property. They therefore deploy their wealth in visible assets (houses, farms, factories, and so forth) that generate economic transactions (buying and selling the output of those same farms and factories, for example) and produce streams of income (wages, rental and interest income, and profits).[8] All of these assets, transactions, and income streams can then be taxed by the government. The low probability of expropriation, and the larger tax base produced by the resulting expansion of economic activity, explain two important characteristics of liberal democracies: They generally have much larger economies and generate far larger tax revenues than other political systems.[9]

The same institutional arrangements that militate against the risk of expropriation or other arbitrary abuses of public authority also work against the creation of entitlement programs that benefit select, narrow constituencies. This is not to say that rent-seeking behavior[10] and

7 Stasavage (2003).
8 Goldsmith (1995), Leblang (1996), Henisz (2000), Keefer and Knack (2002), Keefer (2003).
9 One implication of these features of liberal democracies is that they can mobilize far greater resources for military purposes than other political systems. As a result, they almost always triumph over other states in military conflicts. See Reiter and Stam (2002) and Schultz and Weingast (2003).
10 Rent-seeking behavior consists of an economic or social actor's attempt to extract (typically financial) gains that are disproportionate to the investment or contribution made or that are based on unfair manipulation (often involving government action) of the economic environment. Thus, a company seeking protective tariffs is engaged in rent-seeking behavior

corruption are completely absent, or that there is absolute equality of citizens before the law in liberal democracies. It is to say, however, that democracies characteristically have institutions that are designed to sanction rent-seeking and corruption and that give actors within and without the government the incentive to levy those sanctions. In liberal democracies, moreover, property rights (broadly defined) tend to be enforced universally – for everyone, regardless of their ascriptive characteristics, political affiliation, or social standing. Indeed, popular entitlements such as education and retirement pensions typically expand over time as politicians seek voters' support.[11]

Authoritarian Rent-Seeking as a Solution to the Commitment Problem

What happens when a society is unable to create the institutions of liberal democracy? This situation creates a thorny problem both for the government and for those individuals who control a society's principal sources of wealth. The government depends on wealth holders to deploy their capital to generate economic activity that may be taxed, and wealth holders need the government to arbitrate contracts and enforce property rights. The problem is that there is nothing that prevents the government from behaving opportunistically – by seizing property or taxing away all of the income it produces – once wealth holders have invested their assets. The government cannot resolve this dilemma simply by promising to respect private property and contract rights because, if there are no sanctions for breaking promises, then no promise made by the government is credible.

One particularly common solution to the commitment problem in non-democratic political contexts is the creation of a rent-seeking coalition.[12] We focus on this solution because it was employed by both Porfirio Díaz, the dictator who ruled Mexico from 1876 until 1911, and the forces that claimed victory in the Mexican Revolution

insofar as it hopes to protect or increase its revenues without improving the quality of its products, raising its efficiency, or doing any of the things typically associated with profit-seeking behavior in competitive markets. Profit-seeking activities always carry an element of risk; rent-seekers characteristically attempt to insulate themselves against risking anything.

11 Lake and Baum (2001).

12 For a discussion of the various other solutions to the commitment problem, see Haber (2006).

(1910–1920) and monopolized political power until the electoral defeat of the PRI in the year 2000.[13]

Rent-seeking coalitions do not require formal institutions that limit the discretion and authority of public officials. Instead, the government coaxes wealth holders into deploying their capital by granting them special privileges designed to raise their rates of return high enough to compensate them for the risk that the government will expropriate their property. These special privileges include barriers to market entry that reduce competition, preferential treatment in the courts, and exemptions from taxation.

The whole point of these special privileges is to create an uneven playing field. Imagine, for example, two entrepreneurs: entrepreneur A, whose political connections allow him to win all legal cases brought against his firm; and entrepreneur B, who knows that he will lose all cases brought against him by entrepreneur A. Entrepreneur B is beaten even before he begins, and so he does not invest in the first place. Entrepreneur A can, therefore, charge higher prices than those that he would be able to charge if he faced competition from entrepreneur B. He thus earns "rents" (a rate of return on capital above that available without special privileges) from his political connections. Similar rents can be generated by establishing a tax that all firms must pay but then granting entrepreneur A an exemption from that tax or by requiring special licenses to operate a factory and then only granting that license to entrepreneur A.

What makes these arrangements credible? The wealth holders who have received special advantages know that the government has no real commitment to them; in fact, the monopoly rents they earn give the government an incentive to expropriate their enterprises. This means that unless the returns on capital available to them are astronomically high, some way needs to be found to align the incentives of the government with those of the select group of wealth holders. One such mechanism that investors can employ is to call on foreign states to threaten the government if it reduces their privileges. This approach only tends to work, however, when the investors are politically powerful citizens of those foreign states. A more common solution is for wealth holders to share some of the rents they earn from their special

[13] For two previous characterizations of Mexico's postrevolutionary governing coalition as a rent-seeking coalition, see Blum (1997), pp. 32, 38–9; Lawson (2002), p. 17.

privileges with individuals or organized groups whose support the government needs to remain in power. If the government then reneges on its agreement with wealth holders, the benefits flowing to individuals or groups that can sanction the government will also disappear, giving them an incentive to rebel or withdraw crucial support.

Political and economic systems dominated by rent-seeking coalitions can produce impressive rates of economic growth for sustained periods of time. Frequently, however, these systems contain the seeds of their own destruction. Over the long term, the very rent-seeking arrangements that underpin these systems come to weigh heavily on the economy. Resources are misallocated to industries in which the country has no real comparative advantage; monopolies and oligopolies develop in industries that should be characterized by near-perfect competition. Opportunities are denied to entrepreneurs who possess the required talent and skills but who lack political access or government protection. Moreover, the resources required to sustain the rent-seeking coalition must come from somewhere, usually everyone outside the coalition itself – which is to say, the vast majority of the population. What results is an uneven distribution of wealth and power, which on the one hand chokes off long-run economic development (by limiting the size and depth of markets) and on the other hand motivates groups outside the dominant coalition to rebel. The government can often stave off rebellions by forging an alliance with the organized groups that can rebel against it – but this move, paradoxically, can put the assets of the wealth holders at risk all over again. What is to keep the government and those groups from forming a coalition and jointly expropriating the wealth holders' assets? For all these reasons, then, authoritarian regimes dominated by rent-seeking coalitions are inherently vulnerable to internal conflicts. They are sometimes capable of producing high *rates* of economic growth over the short or medium term, but they generally cannot be sustained long enough to produce high *levels* of economic development.

By design, political and economic systems based on rent-seeking coalitions do not generate much tax revenue. They essentially have two economic sectors: a fast-growing sector that receives special privileges and is lightly taxed, and a slow-growing sector whose property rights are precarious and is subject (at least on paper) to heavy tax rates. The irony of this situation is obvious: The part of the economy that produces most of the output pays few taxes, whereas the other