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# Why is Structural Reform Stangnating in Mexico? Policy Reform Episodes from Salinas to Fox*

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## *Abstract*

*This paper evaluates several hypotheses about why political systems implement structural reforms. It examines Mexico, a middle income developing country with one of the fifteenth largest economies in the world. This paper first argues that enacting market-friendly reforms has been difficult in Mexico, both under authoritarian and democratic governments. It then examines negative cases of policy reform to understand why neither unified nor divided governments have been able to raise taxes, which still do not account for more than 10 of GDP. It concludes that the failure to raise taxes stems from the inability of parties to make credible inter-party agreements about sharing the costs and benefits of reform, an outcome that institutional weaknesses only augment. Powerful interest groups and ideological diversity among deputies and citizens also inhibit the formation of political alliances to raise the country's low tax take.*

## *Resumen*

*Este documento evalúa varias hipótesis acerca del porqué los sistemas políticos promulgan reformas estructurales. Examina a México, un país en vías de desarrollo de ingresos medios con una de las quince más grandes economías en el mundo. Este documento argumenta, en primer lugar, que la promulgación de reformas neoliberales ha sido difícil en México tanto con gobiernos unipartidistas como con gobiernos democráticos. Luego examina varios intentos de reforma de la estructura tributaria del país y de Pemex para entender porqué ni gobiernos unificados ni gobiernos divididos han logrado elevar el nivel de impuestos, el cual aún no representa más de 10% del PIB. Concluye que el fracaso de elevar el nivel de impuestos proviene de la incapacidad de los partidos para llevar a cabo acuerdos creíbles sobre cómo compartir los costos y beneficios de las reformas estructurales, un resultado que aumenta las debilidades institucionales. Los grupos de intereses poderosos y la diversidad ideológica entre diputados y ciudadanos también dificultan la formación de alianzas políticas para aumentar la tasa de recaudación de impuestos en el país.*

## *Introduction*

Both the academic research and popular press appear to agree that structural reform is at a standstill in Mexico. There is also a consensus that divided government has contributed to this slowdown (Wise and Pastor, 2005), even if it is not clear whether something as ominous as "policy paralysis" now exists in Mexico. Divided government first appeared in the 1997, when president Ernesto Zedillo and the Revolutionary Institutional Party (PRI) lost its majority in the lower house of Congress. In the 2000 general elections, voters not only further reduced the PRI's legislative contingent, but also turned over the presidency to the National Action Party's (PAN) Vicente Fox.

It is too easy, however, to make divided government into the culprit for what I will call structural reform stagnation in Mexico. There is no doubt that democratization has activated the checks and balances of the 1917 Constitution, ones that fragment state power almost as much as that of the US Constitution. As Jeffrey Weldon (1997) argues, the power of *presidencialismo* hinged upon one-party (and authoritarian) control of government, not on the constitutional powers of the chief executive. Yet, reform stagnation in Mexico is not only a product of democratization and divided government, that is, of the increase in the number of veto players. It is also a product of high levels of public cynicism and of the absence of public support for more structural reform. Public apathy and a political system that fragments state power thus provide a multiple number of veto points for special interests to block additional structural reform.

This paper will assess this argument in the light of several hypotheses about the decline of structural reform in Mexico. The World Bank's 2006 Institutional and Governance Review of Mexico provides the first four hypotheses examined in this paper, each of which identifies alternative (but not mutually exclusive) mechanisms linking increasing levels of electoral competition and structural reform stagnation. The first, which I have briefly discussed, traces reform deceleration to the increase in the number of veto players and the mounting narrowness of their interests. The second hypothesis suggests that the slowdown in reform is a product of party strategies that are evolving away from large, public-interested reforms. The third hypothesis is that the capacity of parties to make credible intra and inter-party agreements has diminished over time. These agreements, which are a political good that a stable and legitimate party system provides, allow partisan and policy actors to allot the (short-term) costs as well (typically longer-term) benefits that structural reform implies. The fourth hypothesis is that political competition accentuates clientelism, an argument that claims that parties and voters are interested in particularistic policymaking and not with publicly spirited reforms. A final hypothesis, which is my own, argues that the political system is especially vulnerable to the power wielded by special interest groups. It contends that, above and beyond institutional factors, the power of special interest groups is what consistently stymies structural reform.

This paper begins with a balance sheet of structural reforms in Mexico since the Carlos Salinas administration (1988-94). This section not only provides necessary background that informs the rest of my analysis, but also helps make the point that structural reform has been less intensive and extensive than commonly believed. The next section makes some theoretical distinctions necessary to compare reform in policy areas whose content is often quite different. The third section of this paper examines the overall plausibility of the aforementioned hypotheses by examining the accuracy of their assumptions and discussing the constants of policymaking in Mexico since the 1980s.

Though I refer to lots of policy areas in this paper, the final empirical section of this paper focuses on fiscal and Pemex and fiscal policy because these policy areas are vital for the Mexican state. Mexico also ties with Guatemala as the least taxed society in the Western Hemisphere; the Mexican state only collected an average of 10.5% of GDP as taxes between 1980 and 2000 (Elizondo Mayer-Serra, 2001: 51-2). Pemex is responsible for about a third of federal government revenues (approximately 5% of GDP) and is unable to spend enough money to explore for more oil and gas. Most importantly, neither authoritarian nor democratic governments have been able to reform Pemex or to raise the central government's tax take. So, while we can point to a variety of factors to explain why a one-party system was more successful than a democratic one, only an analysis of negative cases can identify the perennial (as well as new) factors responsible for structural reform stagnation.

This paper does conclude that some of these hypotheses do a better job of explaining lack of progress regarding structural reform. Mexico's low tax take does appear to be a product of ideological divergence among parties (as the second hypothesis implies) and the inability of parties to make credible intra and inter-party agreements (as the third hypothesis argues), ones that foment clientelistic and inefficient tax policies (hypothesis 4) and protect special interests (hypothesis 5). Making Pemex into a transparent, sustainable and world-class corporation does seem to be a product of the multiplicity of veto players (hypothesis 1), increasing ideological divergences among parties (hypothesis 2), and the failure of parties to agree on a reform package that allocates the benefits and costs of transforming Pemex. More importantly, though, this paper concentrates on explaining how political system dynamics interact with citizen preferences and interest group behavior —the building blocks of any explanation of lawmaking— to produce structural reform stagnation. It is the inability to forge a political consensus, one that can persuade enough parties and citizens that sacrifices in the present will be rewarded in the future, that is at the root of reform malaise in contemporary Mexico. Increasingly competitive electoral races also makes parties unwilling to take such gambles, both because public opinion is skeptical about reform and because most interest-groups can mobilize on the streets or in Congress to block reforms that threaten their interests.

## *1. Structural Reforms: A Balance Sheet*

Mexico has the reputation of being a “major” reformer. Gradual trade liberalization begun under the administration of Miguel de la Madrid (1982-88), including entry into the GATT by 1985, gave way to a burst of activity under the Salinas presidency. While it is hard to underestimate the number and impact of neoliberal changes (Clavijo and Valdivieso, 2000), it should be harder to overestimate the extent of structural reform in Mexico.

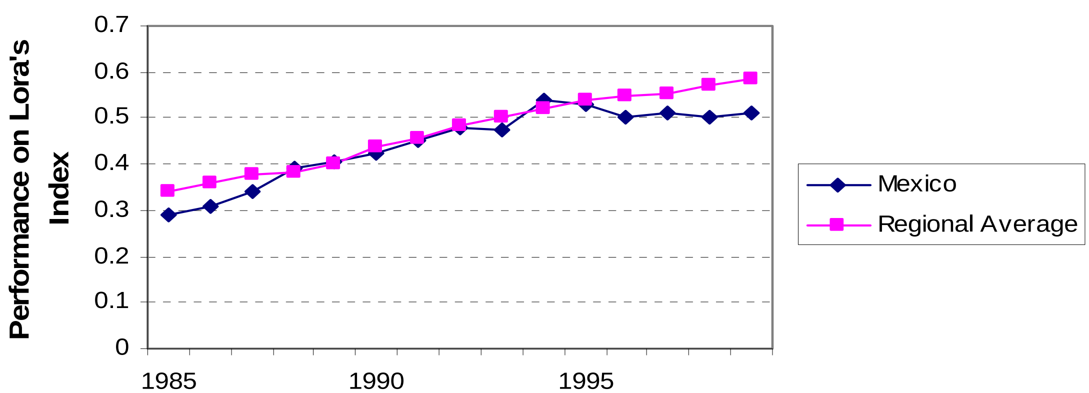
Perhaps the most noteworthy change was the dramatic shift from state to private control of the economy. Between 1983 and 2000, the number of public firms declined from more than 1,100 to about 200 (MacLeod, 2005: 2). During these years, neoliberal reformers privatized two state airlines. They also reprivatized several banks that president José López Portillo (1976-82), during the last year of his term, has nationalized to the surprise of everyone. Perhaps the most important and visible state corporation that was privatized was Telmex. And, while the privatization of the state’s telephone monopoly has improved service, TELMEX is now in the hands of a *de facto* private-sector monopolist. As a result, mexican consumers have to pay some of the highest rates for telecommunications services in the OECD (Mariscal, 2004).

Equally important was the lifting of most trade barriers. After spending much of its history trying to isolate itself from the US and Canadian economies, Mexico signed the North American Free Trade Agreement (NAFTA) with Canada and the US in 1994. As a result, export of light manufactures rapidly increased in subsequent years as the US became Mexico’s main export destination. Mexico also changed its export profile. It is one of the few Latin American countries where minerals and agricultural products are, as of 2002, less than 10% of exports (Economist, 2005: 179). Third, after having redistributed close to half of the national territory to approximately 30,000 *ejidos* or agrarian collectives, the Salinas administration obtained legislative approval (and that of more than half of the state legislatures) to amend the Constitution in 1992 to stop land redistribution. President Salinas also initiated the formalization of *de facto* land titles on *ejidos* as the first step toward the privatization of *ejido* property (Warman, 2001).

For a country with a closed-economy and pervasive state subsidies and controls, these reforms were far-reaching, ones that forced mexicans to change their everyday behavior. It also marks a rather dramatic transformation of a state-led, inward looking development model to one emphasizing export-led development. By 2000, exports and imports account for 60% of GDP, a standard measure of globalization. Moreover, that it took two major economic crises (*e.g.*, 1975 and 1981) before the PRI seriously contemplated trade liberalization and related market reforms suggests that a centralized one-party system went to great lengths to avoid changing its economic policies, an outcome that casts doubt on the alleged benefits of one-party rule.

In comparative perspective, however, Mexico ranks below the Latin American average on Eduardo Lora's Structural Reform Index, a composite measure of change on a variety economic indicators between 1985 and 1999 (Lora, 2001). Lora's Index measures progress on trade and financial services liberalization, tax reform, privatization and labor reform. Chart 1 shows that only during the Salinas administration did Mexico more aggressively reform its economy. By 1999, Mexico was only the 15th most aggressive reformer out of the nineteen Latin American and Caribbean countries that Lora examines. Only during the Salinas administration did Mexico do better than the Latin American average.

**Chart 1**
**Structural Reform Progress, 1985-99**




Source: Lora, 2001

Regional comparisons indicate that a large number of policy areas remain largely unreformed. First, though the Zedillo administration did shift responsibilities for public education to the states in the 1990s, the educational system remains wedded to antiquated methods, including rote memorization. The international PISA tests sponsored by the OECD consistently rank Mexico below not only long-term advanced industrial countries, but also below Asian countries like South Korea whose GDP per capita rates used to be lower than Mexico's (OECD, 2006: 162-5). Interviews suggest that most public school teachers pay union members bribes to become teachers. They also point out that the offspring of teachers can inherit their parent's jobs. Second, there has been no reform of the administration of justice. While president Zedillo did amend the Constitution to create the basis of an independent Supreme Court in 1994, no one has tackled the antiquated methods by which prosecutors collect and analyze evidence, the way subjects are apprehended and treated, and the way the courts judge cases (Zepeda Lucuona, 2004). Third, while public pensions for private sector workers were privatized in 1995 (Madrid, 2003: 93), the central state remains responsible for public sector worker's pensions. In Mexico, the central government's inability to confront highly organized public sector unions, ones that receive pensions out of all proportions to member's contributions, is generating a financial drain on central government finances (Scott, 2005b).

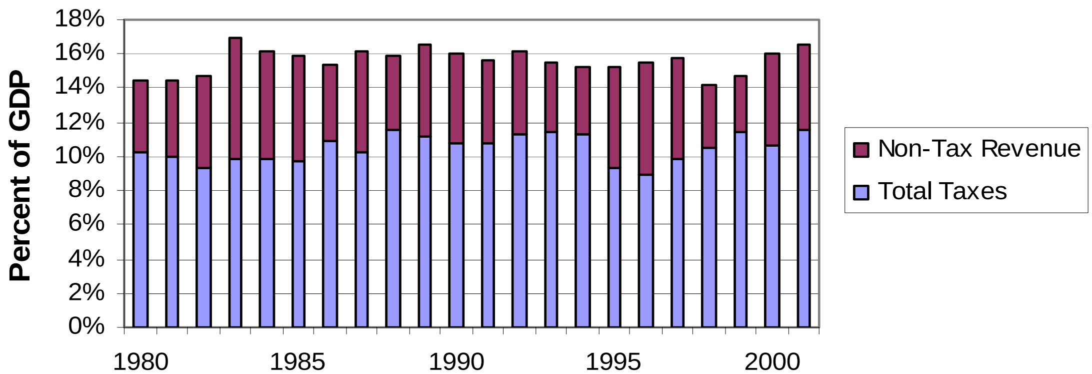
Fourth, reforms to the body politic have not moved beyond establishing a competitive party system. Several economic crises and opposition-led street protests did encourage the PRI to negotiate the opening of the Mexican political system by the early 1990s (Becerra, Salazar and Woldenberg, 2000; Eisenstadt, 2003; Lujambio, 2000). By the mid-1990s, PRI ceded authority to organize elections to an autonomous court system, one that independently updates a state-of-the-art registry, organizes polling stations, tallies the vote, and provides parties with generous amounts of public campaign finance. In 1994, Zedillo also got legislative approval for the reform of a docile Supreme Court, one that involved sacking its current members and dramatically increasing the sorts of cases it could judge. By the late 1990s, the Zedillo administration reformed the fiscal basis of Mexican federalism by, for example, preventing states from incurring debts without foregoing their share of federal transfers.

Many other policy areas never did undergo reform. First, there has been no reform of a Labor Code dating from 1970, even though antiquated legislation empowers old corporatist unions that, using data from 1997, only include 12.9% of the labor force (Bensusán, 2004: 272). Labor unions remain highly centralized and do not permit the rank-and-file to elect the leadership. The leadership of many unions extracts rents by, among other things, demanding bribes from individuals wanting a union job. Second, water distribution and pricing remain unchanged. The National Water Commission (CONAGUA) does not even cover the costs associated with distributing water and many users do not even bother to pay for the water they receive. Estimates suggest that 30-40% of potable water is lost in antiquated and poorly maintained pipes, a situation that is leading to the increasing scarcity of water in several parts of the country. Third, two state companies provide deficient electricity to consumers at subsidized rates and to many businesses at internationally high rates. In 2002, for example, the household electrical subsidy is more than double the amount of the internationally acclaimed anti-poverty program, *Oportunidades* and is regressive (concentration coefficient is 0.3) (World Bank, 2004: 17, 53). Another constitutionally sanctioned state monopoly in energy makes a financially strapped state responsible for electricity generation and distribution, one whose ability to meet future demand for electricity is in doubt (Carreón-Rodríguez, Jiménez and Rosellón, 2005).

Fourth, article 27 of the Constitution also makes the exploration and development of oil a state monopoly. As a result, the private sector cannot get involved in developing new petroleum deposits. Pemex is now exporting more than 3.5 billion barrels of oil a day and the country's reserves are not expected to last beyond 15 years, even though estimates suggest that Pemex needs to be investing roughly $US 10 billion a year (Shields, 2005: 22, 36). Even as the Fox administration has succeeded in raising the annual replacement rate from an average of 26% between 1990 and 2004 to 59% in 2005 (Sojo Garza-Aldape, 2006: 214), the long-term effects of underinvestment in exploration and development undermines the sustainability of this state corporation. Because Pemex supplies about a third of central state revenues, there are real restrictions on its ability to generate the funds for exploration and development. To solve its not so long-term problem, Pemex must reduce its costs, retain a greater share of oil profits, or be allowed to work with the private sector to explore for new oil deposits.

Sixth, the average central tax take has been an average of 10.5% of GDP, since the 1980s, in large part because the state does such a poor job of collecting the taxes on the books. Marcelo Bergman (2004: 237), for example, estimates that the Mexican state collected less than half of the direct and indirect taxes it should have collected between 1989 and 1996. Chart 2 provides annual figures for the tax take to show how stubbornly resistant tax rates have been to real change.

**Chart 2**
**Central State Revenues in Mexico, 1980-2001**
**(as a Share of Annual GDP)**




Source: Elizondo Mayer-Serra, 2001: 51-2.

Mexico has therefore not been one of the region's fast reformers. While the list of 2nd generation reforms waiting implementation is long in Latin America (Lora, 2001), it is larger and longer in Mexico. Only between the mid-1980s and mid-1990s did structural reform move slightly faster than the regional average. The de la Madrid, Salinas and Zedillo administrations were responsible for pushing nearly half of the 416 to the constitutional amendments enacted between 1917 and 2004 —187 to be exact— between 1982 and 2000 (Aparicio, 2005). While constitutional amendment is not the only way to measure the rhythm of structural reform, it does make the point that three neoliberal presidents were unusually active by national standards, with Salinas winning the prize for hyperactivity. Moreover, their constitutional reforms typically destroyed the institutional bases of privileges held by businessmen and special interests. Reforms prior to the 1980s typically created rents as part of a political exchange between the organized sectors of society and the PRI.

As a consequence of structural reform slowdown, Mexican society is stuck in a far from ideal political economic equilibrium. Mexico does not have a very competitive economy. The World Economic Forum's (2005) Growth Competitiveness Index ranks Mexico as the 55th most competitive economy among 117 countries, a slide of 7 places since 2004. It is some distance from Chile, which, at position number 23, is the best ranked economy in the region. The Mexican Institute for Competitiveness estimates that, for example, the cost of administrative regulations is equivalent to 15% of the GDP in 2002 (Fundación Este País, 2006: 131). Lack of competitiveness, along with several major economic crises, helps explain why GDP per capita growth rates have remained largely unchanged since 1975 (UNDP, 2001: 179). Between 1975 and 1999, the annual per capita growth rate has been less than 1%. By 2002, they were $8,800 (PPP US$).

## 1.1 Politically Relevant Characteristics of Structural Reform

In this section, I offer a simple classification of structural reforms. Major changes in the conditions in which economic activity take place, as is widely known, generate costs in the short-term in exchange for benefits in the long-term. Here I wish to offer a few additional distinctions about costs so that we can compare the political impacts of often radically different types of reforms. Having a common metric to distinguish among reforms will help in the evaluation of hypothesis that I pursue in the next section of this paper.

Figure 1 classifies reforms along two dimensions. The horizontal axis identifies the scope (or number) of beneficiaries. Most structural reforms have (potentially) high numbers of beneficiaries. NAFTA helped bring down the costs of many goods and therefore helped large numbers of consumers. The establishment of a semi-autonomous Central Bank and the free flotation of the peso keep inflation down, an outcome that favors all consumers, especially poorer ones. While financial service liberalization and telecommunications reform have not led to internationally low rates for banking and telephone services, their quality has improved over the past 20 years.

FIGURE 1
HYPOTHETICAL COSTS AND BENEFITS OF STRUCTURAL REFORM

| | | DISPERSION OF COSTS | | |
|---|---|---|---|---|
| | | LOW | MEDIUM | HIGH |
| EXTENT OF BENEFICIARIES | LOW | Agrarian Reform | | |
| | HIGH | Telmex Privatized<br>Central Bank Reform<br>Judicial Reform<br>Financial Services Lib. | NAFTA<br>Pemex Reform<br>Pension Reform<br>Electoral Reforms | Tax Reform<br>Education Reform<br>Justice Admin. Reform<br>Water Reform |

The vertical axis of Figure 1 places reforms into low and high costs categories. Agrarian reform was a relatively low cost reform because, by the 1990s, only a quarter of mexicans still lived in rural areas. Moreover, there was little doubt that *ejido*-based agriculture was in crisis and that membership in a land collective was not a ticket to economic prosperity. Telecommunication, banking and judicial reform are also policy areas where the negatively affected interests were small, even if highly organized. When confronted with an executive possessing overwhelming legislative support, the targeted interests agreed to reform their sectors. Indeed, the privatization of the state telecommunications monopoly involved negotiations that left the union in control of a labor force that joined the private sector with few changes in structure (Mariscal, 2004).

Most remaining structural reforms not only have potentially large numbers of beneficiaries, but also involve high costs. Reform of a low-grade system of public education would not only help lower-income families better equip their children with the skills needed to compete in a globalized economy, but would also force elected officials to confront Latin America's largest union. Transforming the police, the public ministry (which holds a monopoly on criminal prosecutions) and the judicial system to improve public security would help most citizens, but also would entail confronting highly organized criminal organizations and complicit public officials. Much the same reasoning applies to labor reform, pension reform and other 2$^{nd}$ structural reform areas. NAFTA and the privatization of small and inefficient state companies were perhaps the most politically costly areas that president Salinas undertook, ones that required the expenditure of large amounts of political capital (and that are responsible for the inaccurate impression that Mexico was a rapid structural reformer). They were high cost reforms because they threatened the interests of public employees, labor and business groups that were key members of the PRI coalition.

Pemex and tax reform are two classic examples of high cost and benefits structural reforms. Though all of society stands to benefit from creating a sustainable and economically state oil company, many proposed reforms to Pemex would have the effect of reducing the amount of revenue that the central state would receive. To make up for the shortfall, state expenditures would need to be cut and/or additional revenues would have to be raised. Similarly, increasing tax revenues would also be of potential benefit to all of society because investment in human and physical capital could increase. Yet, both reforms are not just costly because a corrupt Pemex union can threaten to close down oil fields and because tax evasion is hard to fight. They are politically expensive because both sets of reforms would require increasing the numbers of individuals subject to taxation. Though alternative ways of bundling reforms can shift the costs and benefits of a reform package, the low tax take of the central government means that increasing investment in the population and in physical infrastructure unavoidably involves increasing tax burdens.

## 2. The Causes of Reform Stagnation in Mexico

This section presents the hypotheses guiding this research, each of which identifies mechanisms connecting democratization and divided government with policymaking. In doing so, I identify trends and dynamics about the Mexican political system necessary for the more policy specific analysis I conduct in the next section of this paper.

The first hypothesis is that the number of veto players —or actors whose consent is needed to change the *statu quo*— has changed and that their interests have become narrower.

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The first hypothesis is that the number of veto players —or actors whose consent is needed to change the *statu quo*— has changed and that their interests have become narrower.

**TABLE 1**
**VALID VOTE AND SEAT SHARES IN THE CHAMBER OF DEPUTIES, 1988-2003**

| Election Year | PRI | | PAN | | PRD | | Other | |
|---|---|---|---|---|---|---|---|---|
| | Vote (%) | Seats (%) | Vote (%) | Seats (%) | Vote (%) | Seats (%) | Vote (%) | Seats (%) |
| 1988 | 51.0 | 52.0 | 18.0 | 20.4 | 29.3* | 27.6 | 1.7 | ---- |
| 1991 | 61.4 | 64.0 | 17.7 | 17.8 | 8.3 | 8.2 | 12.6 | 10.0 |
| 1994 | 50.2 | 60.0 | 25.8 | 23.8 | 16.7 | 14.2 | 7.3 | 2.0 |
| 1997 | 39.1 | 47.8 | 26.6 | 24.2 | 25.7 | 25.0 | 8.6 | 3.0 |
| 2000 | 36.9 | 42.2 | 38.2 | 41.2 | 18.7 | 10.0 | 6.2 | 6.6 |
| 2003 | 38.2 | 44.8 | 31.9 | 30.2 | 18.3 | 19.4 | 11.6 | 5.6 |

* Democratic National Front (Coalition formed by PFCRN, PPS, PARM and PMS)
Source: Nohlen (2005).

Democratization has resulted in an increase in the number of veto players, which we can measure in two ways. First, the number of partisan veto players, to use George Tsebelis's (2002) formulation, increased from one in 1988 to two by 1997 for the creation and reform of ordinary laws (using complete absorption or, counting the president and legislative contingent of his party). Not only is the president's support needed to change ordinary legislation because he has a pocket as well as an ordinary veto (which can be overridden by a 2/3 legislative majority), but legal change also requires consent of the Chamber of Deputies and the Senate. Before the mid-1980s, Tsebelis's rules of absorption meant that one-party government made for one veto player, which is another way to make the point that the separation of powers was a lot less meaningful than it is now.

Since the ownership and exploitation of energy, for example, have constitutional-level provisions, the number of veto players is potentially far greater in many policy areas. Even by the late 1980s, the PRI could no longer single-handedly amend the Constitution. There were at least two veto-players in the constitutional reform game. Article 135 of the Constitution requires constitutional amendments to obtain the approval of two-thirds of all legislators by a majority of state legislatures. More than half —or 17 to be precise— of 32 state legislatures must approve each constitutional reform. Though the president is not a player in constitutional-level reform, the incorporation of state legislators means that, depending upon the partisan composition of state legislators, the number of formal veto players can increase enormously.

Divided government has also changed the dynamic of the Mexican political system because executive-legislative relations make for a much weaker executive (Weldon, 1997). If two-thirds of both houses of Congress vote to override the president's veto, the executive must accept a law contrary to his policy preferences. In this case, contemporary Mexican politics can completely reverse the executive-centered version of presidentialism that was the central characteristic of politics for more than 70 years (Nacif, 2004). In general, though, policymaking has shifted from the executive to the legislature during periods of divided government.

Second, a useful way to measure the transformation of policymaking is to use Mony de Swaan and Juan Molinar's (2003) Power Concentration Index, which is a composite measure of the geographic spread of revenues among levels of government and the partisan shares of elected offices among different levels of government. Until 1997, it stayed above 90, less than 10 points from the highest value on the Power Concentration Index. As a result of the 1997 midterm elections, the index dipped to approximately 77 during the second half of Zedillo's presidency. After the 2000 election, it dropped to 50. In less than 3 years, then, democratization produced a 50% reduction in the concentration of power.

A nice feature of Swaan and Molinar's Power Concentration Index is that it incorporates the effects of vertical as well as horizontal decentralization. Not only does the president have to negotiate with a Congress that he no longer (ostensibly) controls, but the decentralization of policy responsibilities to states and municipal governments since the 1980s and democratization have made governors into key players in national-level politics (Rodríguez, 1997). While subnational governments only raise less than 1% of GDP in the form of state and municipal taxes (Elizondo Mayer-Serra, 2001: 14), they were spending 35% of federal taxes (note that states collect federal taxes in Mexico). This represents more than a threefold increase since 1985, when states and municipalities accounted for slightly less than 13% of public sector expenditures. As of 2000, states and municipalities spent 28 and 8% of all public sector monies, respectively (De Swaan and Molinar Horcasitas, 2005: 266).

Finally, it does appear to be the case that interests have become narrower with democratization. Before 2000, PRI presidents could get deputies and senators belonging to their party to endorse some policies that imposed costs on key members of the ruling coalition. Yet, as I argue below, it is easy to overestimate how publicly spirited PRI policies were or could be precisely because the range and scope of interests within the PRI was narrow. With the increase in the number of veto players, however, interest groups use their influence within the PRI, on the streets and within the electoral arena (and then in Congress) to protect their interests. I discuss these issues in greater detail in the discussion of two policy areas.

The second hypothesis is that party strategies have evolved away from large, public-interested reforms.

It is empirically the case that parties shy away from committing themselves to controversial reforms. Structural reform is and has never been popular in Mexico. Once de la Madrid's government began to liberalize trade in the 1980s, left-wing factions of the PRI began to distance themselves from the PRI. Many left the PRI by 1988, when Cuauhtémoc Cárdenas, a long-term member of the PRI, ran on a ticket in alliance with traditional left groups. By the early 1990s, the groups behind the Cárdenas candidacy formed the PRD, a party that equates liberalizing reforms and privatization as a sell-out of national interests. The PRD believes that structural reforms are responsible for the country's anemic economic growth over the past two decades. That Cárdenas's defeat is shrouded in allegations of fraud means that market-oriented reforms became associated with one-party rule, further contributing to their lack of public support.

The PRI has sectors that both support and oppose structural reforms. During the 1980s and much of the 1990s, PRI technocrats held the upper-hand while corporatist groups and other anti-reform groups fought rear-guard actions against structural change (Centeno, 1997). Since the 1990s, the PRI and the PAN exchanged each other's support for constitutional reforms to liberalize the economy and to democratize the political system. By the end of this decade, anti-reform groups became more prominent in the PRI. According to World Values Surveys, citizens identifying with a party (roughly 60% of survey respondents) shifted to the left on redistributional issues. Between 1997 and 2000, PRI citizens moved from being the most right-wing partisans on redistributional policy to being the most centrist ones, a shift that Moreno (2003: 124-9) believes was a product of the PRI leadership becoming more critical of neoliberal reforms in the aftermath of the 1994 economic meltdown. Using Poole and Rosenthal's W-Nominate method on legislative roll-call votes, Weldon (2006) shows that the median legislator within the PRI and the PAN also switched ideological positions.

Public opinion has never been fond of many structural reforms. The public does not support opening up Pemex to private-sector investment because the nationalization of petroleum deposits in 1938 remains a popular act of national redemption. Sixty-five of survey respondents 2004 said that the Mexican government should not permit foreign investment in oil production and distribution (and private sector investment is typically equated with foreign multinational investment) (Kocher and Minushkin, 2005: 32). The public also is skeptical about reforming the tax code, as surveys in my case study of tax reform demonstrate. Support for foreign (private-sector) investment in the electrical sector —another area of state control— is less widespread, but remains important. Slightly more than one half of survey respondents in 2004 —56% to be exact— oppose foreign (private) investment in electrical generation and distribution (Kocher and Minushkin, 2005: 32).

There is some support for some structural reforms in Mexico, even if Latinobarometer surveys indicate that support for market-oriented reforms has declined through time. When asked whether they support the free trade agreement with Canada and the US, 74% of survey respondents in 2004 answered in the affirmative (Kocher and Minushkin, 2005). More than half of those polled in 1998 supported privatization in Mexico. Five years later, only slightly less than a third supported privatization (as cited in Lora, Panizza and Quispe-Agnoli, 2004). These results are consistent with World Values Surveys findings that all partisan identifies of all parties have shifted to the left on distributional issues, even if PRI supporters have shifted most to the left between 1997 and 2000 (Moreno, 2003: 124-9).

So, yes, party strategies have changed because public opinion counts in what have become hotly competitive elections. Like in many other places in Latin America, public opinion is anemic about reforms, not the least because growth rates have been disappointing. There is also a cost associated with being labeled neoliberal, independently of its real or alleged effects, that discourages parties from endorsing structural reform. In a paper using a dataset of aggregate electoral returns, institutional features and economic conditions between 1985 and 2002 from 17 Latin American countries, Eduardo Lora and Mauricio Olivera (2005), point out that incumbents who push pro-market reforms pay high electoral costs, even when such reforms improve macroeconomic performance.

The third hypothesis is that the capacity of parties to make credible intra and inter-party agreements has diminished over time.

This hypothesis appears to be true because, first, parties often disagree profoundly on policy, a topic which I have just examined. Ideological differences make it hard to compromise on policy, and Mexican parties are split about the desirability of more reforms and disagree about their effects of past reforms. Disagreement about policy, which an anemic growth rate only serves to fuel, also inhibits the formation of coalitions to enact further reforms.

Second, the Mexican political system does not encourage parties to make credible intra and inter-party agreements. Unlike most other political systems, all mexican elected officials cannot stand for consecutive reelection. Federal and state deputies sit in Congress for 3 years and then have to look for their next job. Federal senators, governors and the president have 6-year terms. Without reelection incentives, legislators have few reasons to acquire the policymaking expertise to police the bureaucracy or to be accountable to their voters.

Before 2000, unified government under the PRI did encourage elected officials to consider long-term interests. Though deputies and senators could not run for reelection, the regime rewarded loyalty by placing them in other lucrative policy positions. The vast majority of legislative bills came from the cabinet or from the executive departments (Ugalde, 2000) that had the staff and resources to become policy experts in certain areas. Though the Constitution also prevented the president from standing for reelection, he did hold power for a 6-year term (Castañeda, 1999). More importantly, he could designate his successor. *El dedazo*, in Mexican political parlance, maintained policy continuity and reassured members of the revolutionary family that defection was a worse strategy than cooperation with the PRI. Having the longest time horizons, the president was the linchpin of the system—a fact that explains why the PRI is synonymous with the inter-temporal agreement that simultaneously outlived individual presidencies and whose dynamics were defined by *sexenios*.

There is no better evidence of the PRI's inability to make credible intra-party commitments for the sake of publicly spirited reforms than the fact that PRI failed to reform an overregulated, corporatist and closed economy until the 1980s. So, yes, mexicans presidents almost always got their bills approved in Congress (Casar, 2002a), but they refrained from sending bills to Congress that redistributed power away from the corporatist pillars of the regime. When economic growth faltered, as Raymond Vernon (1965) noted four decades ago, Mexican *presidencialismo* was unable to forge the consensus to reform a closed and highly regulated economy. Between 1976 and 1994, presidential succession cycled with foreign exchange crises, inflation and the collapse of economic growth (Basáñez, 1995).

Repeated economic crisis created the conditions for an energetic executive —Carlos Salinas to be exact— to use a centralized political system to enact structural reforms during the 1980s and 1990s. Its control of public offices meant that it could compensate losers with elected posts or governmental positions. A noncompetitive political system also meant that the PRI could disregard many of the public repercussions of its policies, even if it had to engage in a political balancing act between anti and pro-change forces within its ranks that restricted its room for maneuver. With a decline in its political fortunes during the 1990s, the PRI was no longer able to internalize the costs of reform. As a result, the rhythm of reform began to falter, as Lora's Structural Reform Index demonstrates.

The fourth hypothesis is that political competition accentuates clientelism, or that policymaking is about the provision of particularlistic policies in exchange for electoral support.

While Mexican policymaking remains heavily particularistic, it does not appear to be the case that democratization has made it more clientelistic. First, since the 1990s, certain policy areas have become publicly spirited. Not contracting a large foreign debt, maintaining a small budgetary surplus, and letting the peso float (as part of a broader arrangement about establishing central bank semi-autonomy) are policies that the PRI, before the 1990s, failed to endorse out of deference to key members of its support coalition. Moreover, there does seem to be a partisan consensus around macro-economic stability.

Second, in a one-party, corporatist-dominated system, politics was highly particularistic and, to make matters worse, economically regressive. Corporatist leaders, who often lasted for decades, were known more by their proper names and their links with other regime leaders than by their ability to represent the interests of their alleged constituencies. In Pablo González Casanova's (1970) classic, *Democracy in Mexico*, the majority of mexicans —most of who lived in dirt-poor rural areas or migrated to the US or to urban areas (Eckstein, 1977)— belonged to what he called the "marginal" sectors. Unlike members of the formal, urban sector —most of whom belonged to one of the corporatist groups— the regime did little more than to grant them collectively owned *ejido* that often took more than a decade to obtain from none other than the president (Warman, 2001) or to leave the countryside for the city or, like one of five mexicans, to immigrate to the United States. Even members of the formal sector were only allowed to seek redress for their demands through officially sanctioned leaders, most of which more beholden to the president than to their membership. That less than 5% of rural residents and more than 70% of urban dwellers belonged to an officially sanctioned union or association, according to 1960 census data (González Casanova, 1970: 121-2), also testifies to the narrowness of the regime coalition and why its policies were so clientelistic.

Third, while public policies still revolve around the provision of particularistic goods, social policy as a whole has become less regressive. Five of the federal government's 19 major redistributive programs are progressive (concentration coefficients of less than 1.0). These include preschool, elementary, and lower school education, public health and *Oportunidades*. In 2002, they accounted for 35.3% of social program expenditures (World Bank, 2004: 27, 53). While most welfare expenditures consist of the electricity subsidy and pension systems for mostly PRI-affiliated public sector workers, the expansion of pre-secondary school education during the 1990s and the creation of *Oportunidades* 1997 began to redress the blatantly regressive effects of clientelistically organized welfare programs. These results are a product of democratization: electoral competition made governments more responsive to median voters, even if non-consecutive reelection and centralized parties do not institutionalize an effective dialogue between citizens and the state.

Fourth, it does not seem to be the case that clientelistic politics are the way to win the presidency, even though the use of a plurality formula can, in a multi-candidate race (as every presidential contest since 1988 has been), encourage candidates to appeal to narrow groups of voters. The normal distribution of preferences among mexican voters works against these outcomes (Moreno, 2003: 116). Moreover, the electorate is ideologically complex, even if divided unevenly among the three principal parties. Approximately 40% of the electorate identifies as an independent. A third of the electorate remains loyal to the formerly hegemonic party. Opposition parties garner the sympathy of another third of the electorate, with 20% of the survey respondents identifying with the PAN and 10% with the PRD. Though the PRD does compete in rural areas, both it and the PAN thrive in urban areas where more educated voters reside. To win the presidency, each party therefore needs to appeal to centrist voters and to position itself on economic issues that appeal to the median voter who belongs to a household whose 2003 yearly income is US $4,363 (CSEH, 2003; Mexican $11=US $1).

As policymaking shifts to Congress under divided government, key interest groups have increasingly turned to lobbying deputies and senators, each of whom represents a territorially delimited district or state. Centrally controlled nomination procedures mean that key interest groups bargain with the party leadership for slots on closed-list party lists. Table 2 reveals that PRI deputies, for example, still belong to one of the corporatist groups with members of the CNOC increasing their presence within the ranks of the PRI. Organized labor representatives remain influential, though their presence has fallen over time.

**TABLE 2**
**CORPORATIST AFFILIATION OF THE PRI, 1964-2003**

| LEGISLATIVE TERM (NUMBER OF DEPUTIES) | PRI SECTORS (%) | | | PERCENT OPPOSITION DEPUTIES* |
|---|---|---|---|---|
| | PEASANT | LABOR | POPULAR | |
| 1964-66 (N = 178) | 27.0 | 19.7 | 53.4 | 16.7 |
| 1967-69 (N = 173) | 25.4 | 22.0 | 52.6 | 16.5 |
| 1970-72 (N = 177) | 26.6 | 20.3 | 53.1 | 16.4 |
| 1973-75 (N = 192) | 27.1 | 19.8 | 53.1 | 17.2 |
| 1976-78 (N = 196) | 28.6 | 29.6 | 41.8 | 16.7 |
| 1979-81 (N = 400) | 16 | 23 | 60.7 | 26.0 |
| 1982-84 (N = 400) | 17.7 | 23.2 | 59.0 | 25.2 |
| 1985-87 (N = 400) | 17.5 | 24.5 | 58.0 | 26.7 |
| 1988-90 (N = 500) | 17 | 21 | 62 | 48.0 |
| 1991-93 (N = 500) | 14 | 15 | 71 | 36.0 |
| 1994-96 (N = 500) | | | | 40.0 |
| 1997-99 (N = 500) | 37.8 | 11 | 50 | 52.2 |
| 2000-02 (N = 500) | | | | 55.4 |
| 2003-05 (N = 500) | 28.2 | 7.6 | 50.9 | 69.8 |
| *Average* | *23.4* | *19.8* | *55.4* | *32.2* |

Sources: For 1964-1976, see Smith (1979: 227). For 1979, see Pacheco Méndez (2000: 36). For 1988 and 1991, see Reyes del Campillo (1992: 147). For 1982, 1985 and 1997, see Langston (2002: 422, 427). (Pacheco Méndez's estimates for 1985 and 1997 are within 1 or 2 percentage points of Langston's). For 2003, see Reforma (2003a: 5A).
*Until 2000, the opposition consisted of anti-PRI parties.

A rival and complementary hypothesis is that interest groups stymie reforms that threaten their interests. This hypothesis emphasizes that policy areas can be captured by interests that possess organizational advantages and institutionalized power. When structural or other public spirited reforms injure the interests of such groups, then reform will not occur or be watered down substantially.

Prior to democratization in the 1990s, powerful interest groups —organized labor, organized peasants and public sector workers— each had a formal presence within the PRI. They sent representatives to Congress, which in turn limited the president's ability to enact legislation that harmed their interests. Even with a political system with 1 veto player, the PRI was unable to raise taxes, deregulate and liberalize an economy because the narrowness of its support coalition greatly limited its room for policy maneuver. The absence of competitive elections and other mechanisms of public accountability therefore made the PRI dependent upon exchanging particularistic policies to largely urban-based corporatist sectors, an arrangement whose legacy continues to fuel public distrust of the state.

The ability of interest groups to thwart reform is a constant of Mexican politics. What has changed is the political system. So, the sorts of reforms that were hard during one-party rule become harder because divided government creates multiple entry points that allow interest groups to thwart reform. Interest groups now use not only their influence in executive and decentralized agencies to protect their interests, but they also have representatives in Congress and otherwise lobby legislators. Even though the PRI's share of legislative seats has fallen since the 1990s, a multi-party Congress means that far-reaching reforms require cross-party alliances. Indeed, several reforms —including energy reform— need supra-majorities (2/3 of legislators present) in Congress and support from a majority of state legislatures.

## 3. Structural Reform: Case Studies of Tax Reform and of Pemex

To assess the validity of these hypotheses, I now turn to an analysis of two policy areas, ones that have seen very few reforms since the 1980s. These case studies illustrate the mechanisms proposed by each hypothesis, thus revealing how the policy process works in Mexico. An examination of negative cases also introduces the variation necessary to shed light on the relative utility of each of these hypotheses.

Tax Policy: Between 1988 and 2005, there have been five explicit attempts to raise tax revenue. I say "explicit" because executives no doubt would have liked to increase tax rates every year of their presidential administration to spend more on government programs. The fact of the matter is that they made efforts to change laws on four occasions. What legal changes did they propose and enact?

During the first attempt in December 1989, president Salinas succeeded in obtaining legislative support for a 3-pronged package of reforms. First, he introduced a minimum 2% asset tax on business to eliminate the creative accounting that had allowed 70% of capitalists to declare that they were unprofitable (Elizondo Mayer-Serra, 1994: 177). Second, the Salinas administration got Congress to eliminate special provisions for so-called minor tax payers (MTP), which affected 250,000 registered taxpayers. His government also got Congress to repeal Special Tax Basis (STB) for about 1.5 million firms. These legal changes eliminated fiscal privileges benefiting 17% of all mexicans (*Ibid*, 180). Third, the Salinas administration increased penalties for tax evasion, closed loopholes and began to prosecute tax evaders (Elizondo Mayer-Serra, 1994: 181).

During the second attempt in 1995, president Zedillo (1994-2000) got legislative approval to increase VAT from 10 to 15%. During the third attempt in December 2000, president Vicente Fox (2000-2006) considered proposing the elimination of the VAT exemption on food and medicines as one of 4 budget and fiscal bills (The General Guidelines of Economic Policy, the Budgetary Expenditures Bill, a Fiscal Miscellanea and a Revenue Bill) he submitted to Congress within one month of his inauguration.[1] Since the establishment of VAT in 1980, basic food items have been exempt from taxation. Successful lawsuits have gradually expanded the list of exempted items so that, by 2003, slightly more than half of all retail items had become exempted from the paying VAT.[2] After conferring with PAN legislative leaders, the president decided to postpone VAT reform (Calderón Hinojosa, 2000) until the opening of ordinary sessions the following year. Instead, the Fox administration tried —and failed— to strengthen the powers of the administrative authority to prosecute delinquent taxpayers (Reforma, 2000).

The Fox administration again tried to reform tax laws in 2001 and in 2003. In April 2001, it proposed a comprehensive set of tax reforms, including charging all retail products at 15% VAT and gradually reducing the top income tax rate from 40 to 32% (Presidente, 2001). The Department of Finance and Public Credit estimates that VAT reform will generate approximately 121 billion pesos, 45% of which the top deciles will pay. To compensate poor families for the estimated 4.4% reduction in their income, the Fox administration promised to transfer an additional 108 pesos per month to the poorest households in which food item purchases consist of 50% of their expenditures (cited in Vargas Medina, 2001: 18). The Fox administration lost an ultimately unsuccessful game of brinkmanship that dragged on until the last day of 2001. It got no VAT reform, but did get an immediate reduction in the maximum income tax rate to 35% with annual decline of 1% until the 32% rate was reached in 2005 (Reforma, 2001d, 2002).

In its third and final attempt to reform direct and indirect tax laws, the Fox administration changed its legislative strategy. It opted not to submit a bill on its own, given that not consulting bills with legislators before sending bills to Congress had not proven successful. The administration also altered its congressional strategy because the 2003 midterm elections had been a defeat for the president. Though the PAN had run a campaign asking voters to increase the government's congressional contingent ("it's time to unblock change"), the PAN's share of the valid vote had fallen from 38.2 to 31.9% while the PRI's had increased by slightly more than 1% of the valid vote (see Table 1). So, in 2003, the president's legislative liaisons worked behind the scenes with PAN and PRI leaders in support a bipartisan set of reforms. In early December, the Committee on Finance and Public Credit proposed reducing VAT from 15 to 13% and allowing states to charge an additional 2% federal sales tax for their own use. Instead of dropping the exemption on food and medicines, the bipartisan measures called for a special 8% production tax on exempted items. They also consisted of a further reduction in the

[1] While the presidential election is held in July, the start of the new term does not begin until 1st December. Under the pre-2006 budgetary law, legislators had until 31 December to approve the following year's budget.

[2] This figure appears in press reports and legislative debates. An interview with a confidential source on 11 May 2006 with access to Tax Administrative Authority (SAT) documents confirmed the veracity of this claim.

maximum income tax rate to 30% by 2006. Yet again, the Fox administration failed to accomplish its goal, though its reform almost passed and did succeed in splitting the PRI in half (Galán, Hidalgo and Vicenteño, 2003). Why?

The first hypothesis is consistent with the executive's declining legislative success. As the number of veto players increases, the ability of the executive to reform tax laws does decline. There was only 1 partisan veto player when president Salinas and Zedillo got Congress to enact their tax reforms. There were 2 or more partisan veto players when president Fox failed in his efforts to reform tax codes.

A comprehensive analysis of the 2003 roll-call vote, however, suggests that the increase in the number of veto players does not always stymie reform (Langston, 2006). Governors, who have become an increasingly assertive since democratization, did not get in the way of tax reform by 2003. Many actually lobbied their congressional delegations to support president Fox's tax reform bill, in large part because they were promised additional federal funds with the tax reform. Unlike the Fox administration's first and second tax reform bills, the 2003 reform was a product of a 2-year negotiation between the Fox administration and the National Conference of Governors (CONAGO), a governor's association (De Remes, 2006). To understand why negotiations between the president and the governors did not succeed in persuading enough deputies to vote for the executive's bill requires examining the validity of the second and third hypotheses.

In line with the second hypothesis, it is the case that parties remain split about the desirability of publicly spirited reforms like tax reform. A survey of 130 deputies taken between late October and early December 2001 discloses that more than 90% of PRD and PRI deputies were against tax reform. Only the PAN was overwhelmingly in favor of tax reform. Eighty-two percent of the president's party expressed support for the administration's bill. In the aggregate, more than two-thirds of all deputies agreed with the statement that "taxes should stay as they are and that the tax base should be expanded" (Reforma, 2001b).

The reasons behind PRD and PRI opposition to tax reform —or the meaning of "expanding the tax base"— are not hard to discern. First, PRD and many PRI legislators have been ideologically opposed to eliminating the VAT exemption on food and medicines. The legislative transcript is full of speeches against tax reform for these reasons. PRD Deputy María de los Dolores Padierna Luna summarizes the ideological critique nicely when, during the floor debate before the roll-call vote on 11 December 2003, she denounces the Fox administration bill for being "neoliberal" and "perverse". The association between VAT reform and neoliberalism becomes clearer when she exclaims:

> *...In the neoliberal mind, nothing exists but money and markets. They are thinking of the millions of the poor as nothing more than an immense market that can be taxed; they are thinking perversely in the 70 million poor of the country that eat and that, in the end, now must pay taxes; they are thinking of equalizing tax burdens in a huge market and thinking only in pesos* (CD, 2003: 271).

It is not hard to understand why leftist deputies associate consumption taxes with market-based reforms. Proponents of market reform have long championed VAT taxes as the administratively least costly way of raising taxes. Unlike income taxes, VAT does not require the bureaucratic capacity to discern the actual earnings of citizens. Moreover, high income taxes, many technocrats claim, also discourages investment in Mexico, especially in a world where most countries have been steadily dropping tax rates on individuals and corporations. Yet, for PRD and many PRI deputies, increasing consumption taxes instead of closing loopholes or otherwise more efficiently collecting income taxes is part of the policy reforms that they believe are responsible for 20 years of stagnant GDP per capita growth in Mexico.

Second, the PRD and PRI oppose VAT on food and medicine because they claim to represent the ideals of the Mexican revolution, one of whose foundations is support of the popular classes. Any increase in consumption taxes would hurt most mexicans —half of which live in poverty— because the proportion of income that a household spends on food increases as its earnings fall. Moreover, surveys show that PRI draws its support disproportionately from poorer, less educated and older mexicans (Moreno, 2003), who would take a hit on VAT reform. So, there is much to PAN Deputy and Adjunct Coordinator Alejandro Zapata's claim that, within the PRI, "we can find everything: tribes, people ready to support growth in the country and *the dark forces that do not want the country to advance because this can deprive them of benefits of an electoral character*" —emphasis my own— (Reforma, 2001c). While the PRD's does not rely as heavily on lower-class voters, it does not want to alienate the constituency it aims to take away from the PRI.

PRD and PRI opposition to VAT reform makes sense in light of public opposition to tax increases. A telephone survey of 850 adults (with a 3.4% margin of error) in early April 2001, soon after the Fox administration announces its second tax reform bill, revealed that 51% of respondents believed that the executive's recently announced tax reform bill was "unjust". Slightly more than half of this sample —one biased in favor of upper income groups because many poorer households do not have telephones— also believe that taxes should be assessed on income. Only 35% favored taxes on consumption (Reforma, 2001a). As a result, 64% of the respondents supported tax reform with modifications. Two years later, the public also came out against increases in consumption taxes. In a December 2003, 72% of respondents in a household-based survey of 1,513 adults (with a 2.5% margin of error) said it was a mistake for Fox to want to tax food and medicines. Forty-six percent also said they did not believe the president when he claimed that tax reform would be good for Mexico (Moreno and Mancillas, 2003).

Ideological disagreements among parties and public dislike of raising taxes compound the difficulties parties face when trying to make credible inter and intra-party agreements —the central concern of the third hypothesis— to raise Mexico's internationally low tax collection rates. Tax policy, by its nature, is a good that vitiates against alliance formation. If the electorate can identify the politicians or parties responsible for tax hikes, they can potentially punish this party at the ballot box, even while the party or parties that win future elections will benefit from the increased revenues that tax hikes could bring. This helps to explain why the PRI began backing off structural reform like tax reform during the 1990s. As elections became more competitive, the PRI's ability to internalize the costs of reforming the economy began to decline. Whereas a dominant PRI could reward deputies with state employment for taking positions most voters did not want, it is increasingly hard pressed to effect such trades by the end of the 1990s. It is not uncommon to hear PRI politicians say that their loss of the presidency in 2000 stemmed, in part, from promulgating reforms like the increase in VAT taxes from 10 to 15% in 1995 that the electorate opposes (Elizondo Mayer-Serra, 2000).

A reform tricky to enact in any context therefore became even harder in Mexico because the PRD and many within the PRI see none of the benefits of increasing the state's tax take. In their interviews with the press or speeches within Congress, PRD and most PRI deputies spoke about the regressive impact of the VAT side of the tax reform bills. They rarely ever spoke about how VAT or any other tax reform could be used fight poverty or address social wrongs. Their public statements are gloomy reminders of the deprivations suffered by most mexicans and of the state's inability to collect the taxes already on the books.

It is this lack of confidence in the state's ability to act fairly and efficiently that also helps to explain why parties have been unable to fashion agreements to allocate the costs and benefits of tax reform. There is perhaps no better evidence for the political system's lack of credibility than high rates of tax evasion. When all taxes are aggregated, the Mexican state obtains less than half of what it should collect. So, even if politicians could overcome their ideological differences, they face a public skeptical of any claim that short-term sacrifices will generate long-term rewards.

Lack of trust in the neutrality of state administrative authority and in rival parties also helps to explain why the PRD and many within the PRI simply ignored the PAN's arguments that tax reform with VAT changes was not inherently regressive. Especially in the aftermath of its first attempt to reform the tax code in 2000, the PAN spent a fair amount of time explaining how the VAT exemption on food and medicines was an ineffective way to help the poor. The exemption of VAT taxes on food and medicines, in fact, is a set of privileges that masquerades —and with little justification— as progressive policy. While VAT exemptions on food and medicines do make the VAT proportional to income groups, the implicit subsidy disproportionately favors upper-income groups. The top two deciles receive more than a third of the total benefits of the exemption while the bottom two deciles obtain less than 10% of these benefits (Hernández Trillo, 2005: 126-8). For every peso of support that went to the poorest mexicans, the PAN pointed out, the food exemption delivered nearly four pesos of support to the wealthiest mexicans. The PAN's promise to spend the additional revenue on the poorest mexicans nevertheless fell on deaf ears, despite being parts of the president's publicity campaigns emphasized since its second set of tax proposals was unveiled in April 2001.

So, the case that governors could make to federal deputies from their states to support tax reform in December 2003 was never really that persuasive. It was easy, after all, for governors to come out in favor of tax reform because, as a result of president Fox's tax deal with CONAGO, they would not have to take direct responsibility for raising the people's taxes. Out of ideological proclivities, PRD governors never, in fact, tried to mobilize their deputies behind tax reform. PRI governors did manage to overcome opposition within their ranks to eliminating the exemption of food and medicines with the president because the Fox administration had taken advantage of the opportunities created by vertical decentralization of power in Mexican politics. Unfortunately for this coalition, an unforeseen power struggle at the very top of the PRI split the party, one that the declining interest in publicly spirited reforms made possible.

On the face of it, the Fox administration lost the 11 December 2003 vote because the PRI president, Roberto Madrazo, reneged on his commitment to support the reform. Though Madrazo had pledged support for the reform several months earlier, he gradually turned against the tax reform bill because it became a useful way of unseating the PRI's House leader, Elba Esther Gordillo (who also was the Secretary General of the party and remains as head of the Mexican teacher's union), who had come out in favor of tax reform (Gordillo, 2005). This was a particularly bloody battle because both had joined forces to win the PRI's internal elections one year earlier. What had in fact made the kill possible was growing unease within the PRI about supporting unpopular tax reforms, especially ones that promised to affect the household finances of the poorer mexicans who are at the core of the party's constituency. It was "the dark forces", in other words, within the PRI that allowed Madrazo to build a coalition to liquate a rival, one who lost her position as the House leader of the party within the week before the crucial floor vote. In the end, in a 251 *vs.* 234 roll-call vote, 66% of PRI deputies joined the PRD to vote against the unpopular tax measure.

The fourth and fifth hypotheses —about clientelism and the power of interest groups, respectively— also contribute to explaining the persistence of several characteristics of the Mexican tax system. First, clientelism, or the exchange of electoral support for particularistic policies, is consistent with a tax code riddled with exemptions and tax privileges. Elizondo Mayer-Serra (2001: 79-85) lists a Byzantine number of exemptions, ones that include no VAT taxes on books or magazines (a break in favor of the country's chattering classes), on private school tuition (for the 20% of children belonging to households that can afford to opt out of generally deficient public school education), on annual, end-of-the-year bonuses (for formal sector workers, half of which belong to officially recognized unions), and dozens of other items and services.

Particularistic policymaking becomes commonplace because of the power of interest groups, the point that the fifth hypothesis makes. Tax reform prior to the 1980s rarely got off the ground because businessmen typically succeeded in blocking efforts to increase the tax take (Elizondo Mayer-Serra, 1994). President Díaz Ordaz (1964-70) in 1964 tried to reform tax laws so that the government could obtain more than 6-7% of GDP, but failed because businessmen —informal members of the PRI— mobilized their supporters to block reform. That the government also wanted to encourage capitalists to invest in the economy actually encouraged the government to offer (what else?) tax incentives for capitalists. During the presidency of Luis Echeverría (1970-76), the government also tried and failed to raise the tax take. Again, businessmen mobilized their informal networks to discourage president Echeverría from enacting a tax reform. The regime's interest in spurring economic growth to feed a growing pubic debt apparently constrained populist Echeverría from confronting capitalists. So, at the height of Mexico's one-party regime, presidents could not get everything they wanted. Precisely because the corporatist bases of the regime were narrow, policies that entailed injuring the interests of regime supporters remain incredibly hard to enact.

Tax breaks and loopholes persist because, in the first place, their beneficiaries can join forces with parties to block change. Leaders of labor unions, for example, still mostly belong to the PRI. If the PRI, for electoral reasons, opposes tax reform, then it can bargain with other parties to ensure that tax breaks for specific constituencies remain on the books. In the second place, fiscal jurisprudence foments litigation. Even during the heyday of the PRI, the Supreme Court did develop a jurisprudence protecting the rights of taxpayers, even though it kept a safe distance from interpreting electoral law or other classic areas of constitutional law (Lehoucq, *et al.*, 2005). Under the Mexican tradition of amparo, any citizen can file an injunction against any public decision that they claim infringes upon their individual rights. When combined with a jurisprudence that favors taxpayers rights, writs of amparo permit a powerful "minority" (*e.g.*, law firms and their clients) to obtain relief against administrative and legislative acts in fiscal matters (Elizondo Mayer-Serra and Pérez de Acha, 2006). A tax code full of exemptions, in fact, encourages litigation that Convergence Party Deputy Jesús Emilio Martínez Álvarez estimates generate approximately 25 thousand cases a year —and were a reason prompting him to support the December 2003 tax reform bills (CD, 2003: 261).

State Petroleum Policy and Pemex: There is widespread consensus that Pemex is not a well-run company. It has been running a red balance sheet over the past several years in large part because the government appropriates more than two-thirds of its revenues. After paying for operating expenses and debt obligations, Pemex does not spend enough money on exploration and development, whose needs are judged to be in the range of US$10 billion a year (Shields, 2005: 22). Pemex, as of 2005, is exporting more than 3.5 billion barrels of oil a day and the country's reserves are not expected to last beyond 10-15 years (*Ibid*, 36). By international standards, Pemex has too many employees [approximately 138,000 in 2003 (León and Rosado, 2005)], 80% of which belong to a union closely aligned with the PRI. Labor contract rigidities prevent the corporation from relocating excess employees from one area of the country to another. A corrupt union sells posts or lets members of the union will their posts to their offspring. It also has extracted generous salary and pension benefits uncommon in Mexico that have created liabilities that put a further strain on Pemex's financial resources. Until 1984, the petroleum workers union controlled half of Pemex's investment budget (Salinas, 2000: 507).

Most analyses concur that Pemex has not maximized the interests of its alleged principals, the mexican people. While differing in emphasizes, most analysts agree that at the root of the company's problems is the absence of operational autonomy. The Secretary of Finance is the chairman of Pemex's board of directors. Six other departmental secretaries sit on its board. The Pemex union names another five members of the corporation's board. As a matter of routine policy, the PRI 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. Depending upon the estimate agreed upon by the executive and legislature, Pemex's budget —as well as that of the central state— falls or rises.

Since the mid-1980s, there have been three 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 the 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). 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. Second, during the first half of his administration, president Zedillo tried to privatize one of the four companies, Pemex Petrol Chemicals. Zedillo actually never sent a bill to Congress to privatize this part of Pemex because of opposition from within the PRI.

Since the 2000 elections, leading administration officials have publicly discussed the importance of reforming Pemex. Executive officials have focused upon efforts to increase the efficiency of the four Pemex subsidiaries, making the state corporation more transparent and accountable, and in increasing funds for exploration and development. Administration spokesmen have 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, executive proposals have been part of a much broader policy debate about what to do with Pemex. Between 2000 and April 2006, elected officials have presented more than 100 bills having to do with Pemex and petroleum-related laws.[3] 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 has only proposed half a dozen bills to Pemex and oil-related matters, mostly in the second half of his administration. 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). Whatever the exact

[3] This is my count of bills presented to amend the following laws: Ley Federal de Derechos, Ley de la Comisión Reguladora de Energía, Ley Orgánica de Petróleos Mexicanos y Organismos Subsidiarios and Ley Reglamentaria del artículo 27 Constitucional, en el Ramo de Petróleo. I used the search database function of the Gaceta Parlamentaria (http://gaceta.diputados.gob.mx/base) on 22 May 2006.

combination of factors, the Fox administration only proposed —and got— relatively minor changes in Pemex's legal environment.

So, the third and last set of changes to Pemex since the Salinas administration has been new fiscal laws for Pemex and for the state as a whole. By late 2005, Congress approved a new Royalties Law for Pemex (*Ley Federal de Derechos*). Presented in September 2004, the royalties law reform bill aimed to restructure how Pemex is taxed. Prior to the reform, Pemex turned over 61% 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 prices for oil, 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. After a year-long debate, the Fox administration did change Pemex's fiscal laws, 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 its use, an amount that will gradually increase in following years. This figure represents 20% of the estimated amount of an appropriated investment budget and 5% of the estimated value of oil exports in 2006 (Galán y Merlos, 2005: 10A). Parallel to these efforts, the executive and Congress passed a new Law of Budget and Financial Responsibility in early 2006 that, among other things, allocates 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%), infrastructure investments (25%), oil income (40%), and programs and projects for state-level infrastructure and equipment (10%).

This overall lack of progress on reforming Pemex is consistent with the first, veto players, hypothesis. President Salinas could take rather drastic actions against the Pemex union because he was the head of the single veto player in the legal reform game and one of two veto players in the constitutional reform game. Yet, the veto players argument is inconsistent with Zedillo's inability to privatize Pemex Petrol Chemicals, even though, during the first half of his administration. This hypothesis, however, does shed light on the political system's incapacity to tackle Pemex's problems since 2000. Multiple veto players do make changing the *statu quo* harder because their agreement is necessary to reform Pemex. Though the Chamber of Deputies did approve the executive's bill, it underwent significant changes in the Senate before the lower house approved it and sent it to the president in June 2005. Two months later, the Fox administration vetoed the bill, in part because the CONAGO came out in opposition to a bill that reduced its guaranteed share of oil income (Reforma, 2005a). Over the next couple of months, the executive and legislature agreed on a set of reforms that slightly reduced Pemex's tax burden by taxing the corporation on its net and not total income. The compromise, worked by early November 2005, also involved ensuring that the states would continue to receive a steady stream of federal revenues, both by writing in formula into the new Pemex law and the 2006 budget law.

The inability to reform Pemex also makes sense in light of the second hypothesis, the one that claims that parties are decreasingly interested in publicly spirited reforms. Salinas's decision to jail a corrupt union leader must have been applauded, but public opinion must have been skeptical regarding his decision to dismantle the institutional manifestation of Mexican sovereignty. Public opinion must have also been wary of president Zedillo's failed attempt to privatize Pemex Petrol Chemicals. And the overwhelming public support for keeping petroleum in state hands constrains the menu of alternatives that any chief executive has. The inability of parties, however, to reform Pemex is less of a product of the narrowing of their electoral strategies, but of the quasi-sacred quality that state control of petroleum has in the Mexican political universe.

Like in tax reform, the difficulty of making credible commitments makes it hard to reform Pemex, as the third hypothesis suggests because the electoral costs and financial benefits of reforming Pemex would accrue to different agents. Reforms worked out in the present generate costs and benefits that future officeholders and the public at large must share. The existence of fewer veto players made it easier for Salinas to change the *statu quo*, in part because he could use the promise of future appointments and other benefits to keep skeptical PRI deputies behind his proposals. Now that politics is very competitive, it becomes harder for elected officials to take actions the public does not want, even if internal corporate reform and private sector involvement could improve Pemex's performance and increase its long-term prospects.

It is also the case that any serious reform of Pemex would reduce the amount of resources the central state receives from Pemex, a cost that makes it vital that parties, public agencies and bureaus agree to share the costs and benefits of reform. Thus far, the democratization of Mexican politics has not generated the incentives to build inter and intra-party agreements that tackle any of Pemex's serious problems. Extraordinary oil rents derived from the high price for oil since 2003 did provide the conditions for state governors and the federal executive to work an elaborate agreement about how to share windfall profits, one that increase the dependence of state governments on non-taxable sources of income and that increases resources for Pemex.

The last two hypotheses also cast some light on why there has been no major reform of Pemex. While policy towards Pemex is not the object of clientelistic policymaking because most of its revenues are transferred to central state coffers, there is not insignificant amount clientelism in this sector. Again, there has been a decline in rent-seeking through time. After the mid-1980s, the union lost its ability to direct one-half of Pemex's investment budget. The creation of four subsidiaries and the long-term reduction in the size of the unionized labor force has also lessened particularistic policymaking.

The last hypothesis —about the power of interest-groups— also helps to explain why there has been no overhaul of Pemex. 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 union leaders have. 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", (the requirement whose irony was lost on anti-reform forces) 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 (Reforma, 2005b). Indeed, a prominent economic journalist minimized Pemex reform because the union had again demonstrated its ability to stop the reform of the corporation's corporate governance. According to Enrique Quintana, the lack of corporate governance effectively means that it is unlikely that additional monies for Pemex will be well spent, much less spent on needed investment.

Failure to reform Pemex is not really a product of the increase in the number of veto players because one-party governments could also not do much to change the constitutional protections that oil exploration and development enjoys in Mexico. Reform is hard because public opinion is against reforms that can be portrayed as sell-outs to foreign corporate interests. Energy sector reform also requires forging an agreement among two or more parties, each which has programmatic differences about the role of the public and private sectors in the economy. The increasing decentralization of federal expenditures, along with the state's dependence on oil-generated revenues, also makes governors into veto players whose consent is necessary to allocate the short-term costs and longer-term benefits that energy sector reform requires. Furthermore, unions can mobilize support within a fragmented system to stop legal and constitutional changes (not to mention to strike and to paralyze an industry that generates a third of all central state revenues) that threaten their privileges and rents embedded within the energy sector *statu quo*.

## Conclusions

The “big bang” era of structural reform is over in Mexico. During the Salinas presidency, the Mexican state shook off its policy lethargy to introduce a raft of reforms, including extensive trade liberalization and large-scale privatizations. While never a structural reform leader in Latin America, the last three presidents did more for the cause of reform than the Fox administration, the first democratically elected government in more than 70 years. Since the mid-1990s, in fact, the pace of reform has slowed down. The failure to reform education, labor, energy, fiscal and energy policy is undermining the competitiveness of the Mexican economy. Unfavorable comparisons between Fox and his predecessors, however, conceal more than they reveal about the political and institutional causes of structural reform malaise in Mexico.

This paper examined a multitude of policy areas to shed light on several explanations of structural reform stagnation. The persistence of a low tax take is a result of the inability of parties to make credible intra and inter-party agreements, ones that foment particularistic and inefficient tax policies and that protect special interests. The existence in multiple veto players and a decline in public spirited reforms seem to be the key factors explaining the overall absence of reform of Pemex. The declining capacity to make credible intra and inter-party agreements helps to explain why efforts to increase tax revenues and to make Pemex a more efficient and sustainable company is at the root of the persistence of an unfavorable policy *statu quo*. The increase in the number of veto players, along with the activation of the separation of powers in the 1917 Mexican Constitution, vitiates against long-term policymaking. So, while certain factors exert more or less influence on the success or failure of specific policy reforms, it is the combination of these factors that contributes to reform stagnation.

My analysis has several implications for the politics of structural reform. First, Salinas and, to a lesser extent, De la Madrid and Zedillo, were unusually active executives. It is a mistake to generalize about the alleged virtues of one-party government from several neoliberal presidents. Before the 1980s, though, unified (and corporatist) government was a lot more powerful in appearance than in reality. Economic and political crises, along with unified government, empowered these three —especially Salinas— to force, cajole, or otherwise convince corporatist sectors within the PRI to accept painful changes. Since 2000, policymaking has again become rigid, even if electoral competition has made it more public-regarding. The absence of such crises, along with a more porous and democratic political system, therefore makes it much harder for any president —Fox included— to wring policy concessions from the political establishment.

Second, the existence of multiple veto players is not the only or key impediment to more structural reform in Mexico. One the one hand, the public is against or skeptical about more reforms. In the context of highly competitive races, the unpopularity of reforms only discourages parties from advocating their necessity. On the other hand, virtually all policy areas that need reform have interest groups that benefit the *statu quo* and that are more than ready to mobilize to thwart change. This is a long-term constant of policymaking, one that best explains the return of rigidity to policymaking in Mexico, and is the most important legacy of 70 years of democratically unaccountable governments.

Third, structural reforms to improve the competitiveness of the Mexican economy are going to require structural reforms of the body politic. The fragmentation of power, along with the existence of powerful interest groups, makes it hard to alter a suboptimal *statu quo*, one whose effects the public dislikes, but whose policies it supports. The inability of parties to forge credible inter and intra-party agreements is rooted not only in this equilibrium, but also in a political system that provides reform-oriented forces with few incentives to change the policy *statu quo*. Removing the ban on consecutive reelection, along with decentralizing candidate nomination procedures, should make legislators more interested serving their constituents, a result that would increase the credibility of the political system. Increasing accountability also should increase the number of legislators interested in becoming policy experts and in policing the bureaucracy and in the long-term impact of public policy. Perhaps the best way to improve political system performance is to empower presidents to advance a reform-oriented agenda. Currently, the chief executive is the only officeholder that is elected from a national constituency and therefore has some claim to represent the public interest. Moving to a majority runoff system to elect the president will increase the probability that the winner appeals to as large a number of citizens as possible. Reducing the length of the six-year term should also make the executive more responsive to public opinion because citizens could more frequently evaluate presidential politics. These reforms will improve the quality of the dialogue between citizens and the state and therefore increase confidence that short-term sacrifices will generate benefits as amply distributed as possible.

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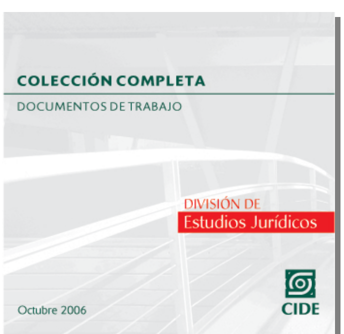



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