The Network of Redistributive Corruption – Exploring Mexico's Paradoxical Corruption-Inequality Trend Post-2001

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> *"El que no 'tranza', no avanza." ('He who does not cheat, does not move forward.')*
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> *-Colloquial Mexican proverb*

Mexico's mechanisms of redistribution appear to be tied to corrupt structures and actors. As such, the economic survival of many of its sectors hinges on the continuance of certain types of corruption. As long as this is the case, appeals for a "culture of integrity" that rejects corruption may continue to be ineffective – especially as corruption at the top levels continues unpunished. If economic security depends on it, then incentives are too great to reject corruption altogether – "hard" measures are also ineffective and risk backfiring by squeezing opportunities at the bottom.

What is needed is a strategy that realigns incentives – where corruption leads to more inequality and anti-corruption leads to less – and attacks the problem on two main fronts: 1) taxes must become much more effective at redistributing resources to the bottom and limiting evasion at the top levels – this may achieve higher credibility of government processes and eliminate reliance on corruption for redistribution, 2) accountability measures at the higher levels must gain teeth to adequately deter graft from officials – the

independent watchdog backed by civil society groups is the first step. Success on these two fronts will result in Mexicans restoring faith in their government's capability to distribute resources and replace "competitive corruption" with competitive, effective governance.

Introduction

In late 2014, Mexico's President Enrique Peña Nieto and some of his closest associates stood accused of using their political influence to buy luxury homes at suspiciously low prices from close government contractors. The following months, multiple state governors throughout Mexico (most of them belonging to the PRI – the Revolutionary Institutional Party - Peña Nieto's party) faced serious charges of illegal enrichment, embezzlement and narco-connections; several of them fled the country to avoid trial while others wound up in prison. In the notorious case of Veracruz governor Javier Duarte, a journal presumably belonging to his wife was found in a warehouse with the phrase "*Sí merezco abundancia"* ("I do deserve abundance") scribbled repeatedly for a full page, as if to self-justify such excess in a state where 60% live in poverty[1].

Unfortunately, these cases are not exceptional in Mexico, where corruption costs the country anywhere from 2 to 10% of annual GDP[2]. Although ensuing pressure on officials led to the creation and enactment of a National Anticorruption System (SNA) in July 2016, it has been conceived devoid of teeth, leading its higher ranks to a quick resignation, and is viewed by an incredulous citizenry as a band-aid solution to a widespread cancer. Mexico's Corruption Perceptions Index in 2017 was 29/100 - back down to late 1990s levels - and ranks a distant last in OECD countries.[3]

There is another related phenomenon plaguing Mexico that has not been sufficiently addressed in the fight against corruption: inequality. Despite regionwide but moderate decreases in inequality since 2000, Mexico continues to score worst of OECD countries in this measure.[4] Moreover, Mexico's pre- and post-tax Gini coefficient changes are negligible[5]: the state's redistribution mechanisms are completely ineffective.

Research has repeatedly shown how corruption and inequality coexist in a vicious cycle that disproportionately affects the poor.[6] As the rich and powerful become richer and more powerful, their influence allows them to cement policies that accentuate disparities and hinder growth in poorer sectors. Stark socioeconomic inequality has deprived a large sector of the population from economic progress enjoyed especially by the wealthy and higher middle classes. Figure 1 highlights how this vicious cycle

[1] Staff. Inseguridad, pobreza, deuda: el Veracruz que dejo Duarte." *Animal Politico.* 15 Apr 2017.
[2] Agren, David. "Mexico leaders' pledges fall short as graft remains 'heart of political system'." *The Guardian* 19 Jul 2017
[3] Martin, Will. "These are the 16 most corrupt countries in the Western World." Business Insider 29 Jan 2016.
[4] OECD Income Distribution Database (2016) – Ourworldindata.org/income-inequality/
[5] Ibid.
[6] Heinrich, Finn. "Corruption and Inequality: How Populists Mislead People." Transparency International. 25 Jan 2017.

can work to destabilize governance, weaken state capacity, empower populist demagogues or alternative criminal structures, and undermine sustainable long-term growth – issues that have long pervaded in Latin America:

Figure 1 (source: Transparency International):

While this mechanism disproportionately benefits the rich governing elite at the expense of the country's growth, it has also accommodated alternative redistribution mechanisms and economic power structures – social pressure escape valves - such as black or gray market activities which, to some extent, may attenuate inequality, albeit ineffectively. While in highly repressive states, competing structures are often hindered from thriving, in states like Mexico, the PRI's corruption scheme was pervasive and malleable enough to allow "escape valves" to be incorporated as a faction of the party's extensive pay-to-play scheme. Everything from drug trade to undemocratic teachers' unions could thrive under the tutelage of the hierarchical governing elite.

During the final years of PRI reign, there was no discernible relationship between levels of corruption and inequality. However, when the PRI lost the presidency in 2000, the corrupt practices of government diversified and decentralized, leading to a puzzling relationship where greater corruption appears tied to *lower* levels of inequality. Mexico appears to be caught in a vicious cycle where corruption networks are intimately tied to key governance activities and mechanisms of redistribution. This deep-rooted structure has created perverse incentives to engage in "equalizing" corrupt practices and strips typical anti-corruption measures of their effectiveness.

Policy Issue

Despite most cross-country research establishing a positive trend between levels of corruption and inequality, both the causal mechanism and the relationship that exist between these two phenomena remains ambiguous. Because these relations have not been sufficiently explored and understood, policies to abate corruption or reduce inequality have often been developed separately, often working at cross-purposes and reducing the general effectiveness. For instance, what happens if reducing corruption closes off crucial valves by which inequality is mitigated? In certain environments, the long-term effects of these policies might afflict, or disproportionately target, populations they intend to help and foster corruption in more damaging ways. As Levgold mentions, context matters in anti-corruption policies: "To some what seems a blight on economic and political progress for others serves as an inevitable, even necessary, aspect of change in chaotic and uncharted periods of transformation."[7] (Levgold 2009) In Mexico, the last 18 years have been transformational in every sense, but unfortunately, the transformation seems to have changed the players, while leaving the game intact. Not only has corruption not abated, but it seems to have followed the paradoxical trend that Dobson et al. describe in their cross-country study on Latin America:

> Conventional economic thinking says corruption and income inequality are positively related. In contrast, this study finds that lower corruption is associated with higher income inequality. The finding of a trade-off is not unexpected in the context of Latin America, for two reasons. First, Latin America has a large informal sector and corruption-reducing polices impose a transaction cost on this sector whose members are among the poorest. Second, redistributive measures, promoted by corrupt elements in society, are often cut back with institutional reform and this serves to worsen inequality. The results imply that corruption-reducing policies aimed at lowering inequality may be misguided. (Dobson et al. 2009)[8]

This paradoxical trend is clearly observable in Mexico after 2000. The relationship between Mexico's Corruption Perception Index and Gini coefficient between 1995 and 2015 sheds no significant statistical relationship (Fig. 2). However, if we analyze the relationship of these same measures from 2001 to 2015, we find that a 1-point rise in CPI, i.e. *an improvement in corruption*, is significantly associated with a .008 rise in Gini coefficient, i.e. *a higher rate of inequality*, (Fig. 3):

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[7] Legvold, Robert. "Corruption, the Criminalized State, and Post-Soviet Transitions." Corruption (2009).
[8] Dobson, Stephen, and Carlyn Ramlogan-Dobson. "Is there a trade-off between income inequality and corruption? Evidence from Latin America." Economics letters 107.2 (2010): 102-104.
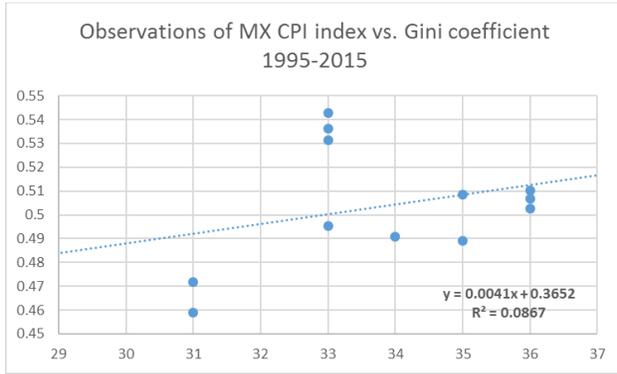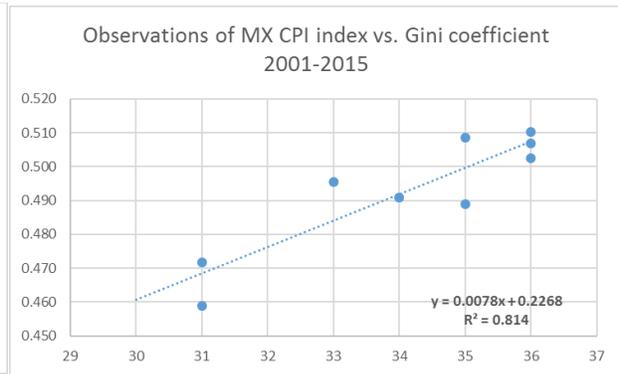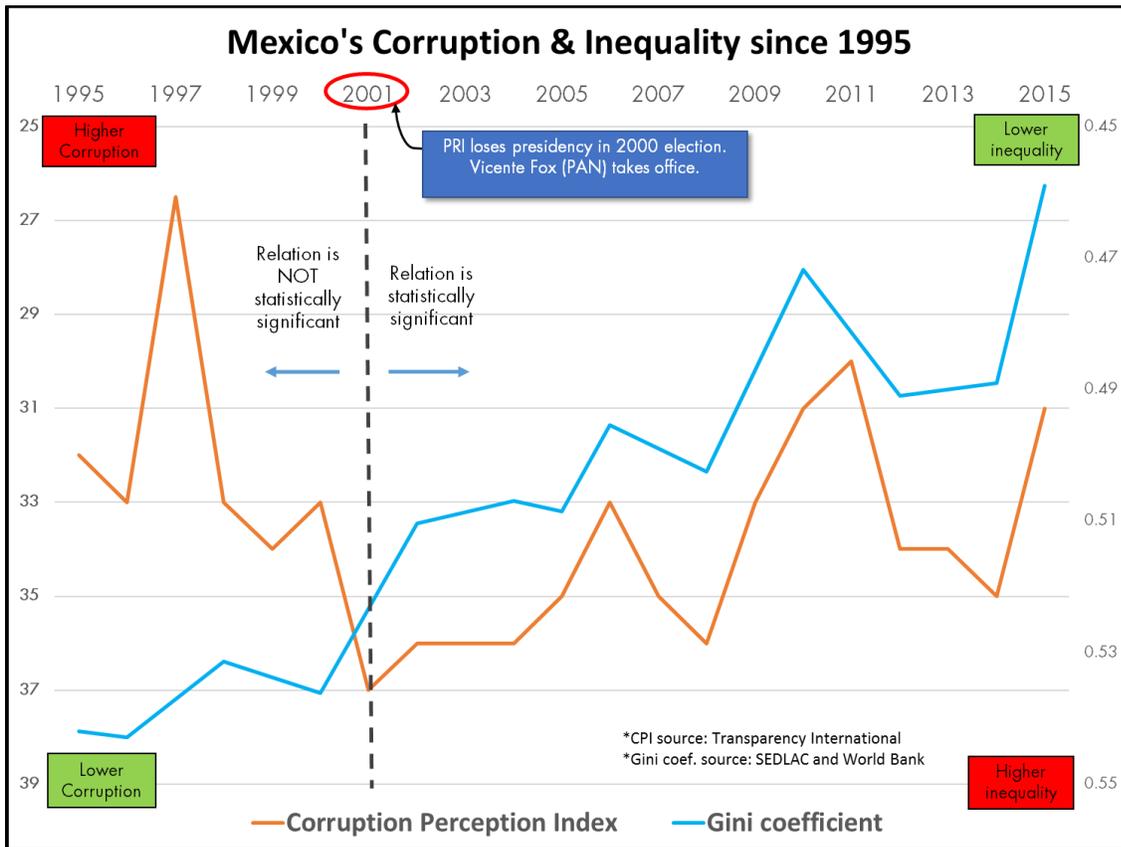
Figure 2   **Figure 3**

These trends are more clearly observable in the figure below:

Figure 4

The Mexican case is particularly enlightening on the corruption-inequality relationship because of the dramatic shift in dynamic that appears following a clear, distinctive shock to the national political structure, the PRI's loss of the presidency in 2000. This shock to the Mexican political system and its subsequent effect on the interplay between corruption and inequality reveals several points: 1) broadly,

we cannot assert causality or a direct relation between corruption and inequality, but we can reasonably assume that they are closely linked; 2) corruption does not always breed inequality, in which case there may be perverse incentives to engage in corrupt practices that may not be easily reversible by traditional or superficial anti-corruption measures, and 3) the realignment of incentives following the breakdown of a system based on corruption may not necessarily lead to lower levels of corruption overall. Indeed, it is often in such uncertain, decentralized environments that certain corrupt practices might be most effective at levelling the playing field. As Teets and Chenoweth state: "According to the 'positive corruption' arguments, corruption might alleviate security concerns by allowing citizens to bypass ineffective or overburdened state institutions and channel political demands through informal avenues."[9] (Teets et al. 2009)

The following section analyzes these paradoxical trends and draws conclusions on what they imply for policy in Mexico and beyond.
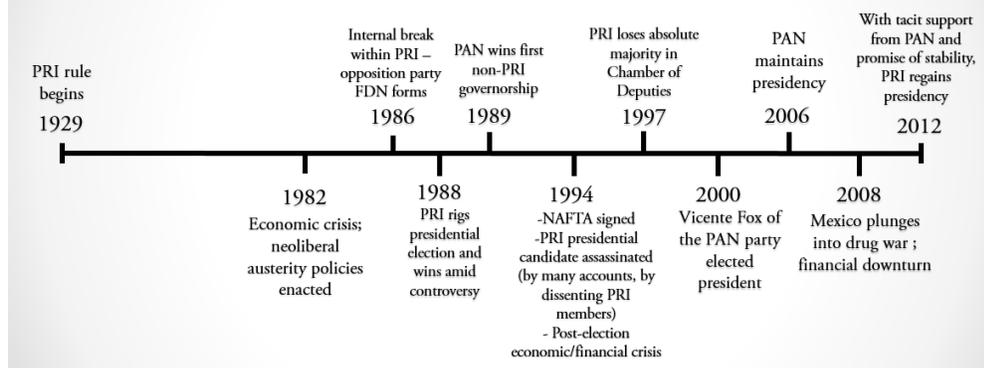
Analysis

To understand why Mexico's post-2000 years were such a seismic shift, it is important to understand how corruption existed within the political structure leading up to that point. The PRI ruled Mexico uninterruptedly from 1929 until 2000. While its centralized, all-encompassing political structure began to show its cracks in the late 1980s with the loss of the first governorship in Baja California and was dealt a devastating blow in 2000 with the loss of the presidency to Vicente Fox of the National Action Party (PAN), for decades it knit an intricate web of influence, clientelism, and corruption which pervades to this day. During the one-party rule years of the PRI, Mexico was essentially run as a "criminalized state", defined as, "[…] one where much, if not most, state activity has been 'privatized'; that is, where either those in power or those with leverage over those in power use state agency to advance their private interest at the expense of the broader public good"[10] (Farer 1999). The evolution of this governmental structure effectively made corruption a fixture of the system, conditioning economic growth to these rules. Figure 5 shows a timeline of key events of the PRI and the Mexican political sphere leading up to modern times:

Figure 5:

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[9] Teets, Jessica C., and Erica Chenoweth. "To Bribe or to Bomb: Do Corruption and Terrorism Go Together?." Corruption, Global Security and World Order, Brookings Institution Press, Washington DC (2009): 167-193.

[10] Farer, Tom J., ed. Transnational crime in the Americas. Psychology Press, 1999.

Timeline of PRI Rule in Mexico

PRI rule begins — 1929

1982 — Economic crisis; neoliberal austerity policies enacted

Internal break within PRI – opposition party FDN forms — 1986

1988 — PRI rigs presidential election and wins amid controversy

PAN wins first non-PRI governorship — 1989

1994 — -NAFTA signed -PRI presidential candidate assassinated (by many accounts, by dissenting PRI members) - Post-election economic/financial crisis

PRI loses absolute majority in Chamber of Deputies — 1997

2000 — Vicente Fox of the PAN party elected president

PAN maintains presidency — 2006

2008 — Mexico plunges into drug war ; financial downturn

With tacit support from PAN and promise of stability, PRI regains presidency — 2012

Decentralization of political power in Mexico came as a double-edged sword: rather than a panacea for corruption, it allowed access to more actors, bringing about "competitive corruption". As more actors began to join the political fray under different parties or groups of power, competition for influence may have led to greater redistribution, as has been shown in the general trend since the late 1990s. Naturally, it also led to higher incentives to harness the redistributive mechanisms of the state through corruption or even coercion. Speaking to the crisis with respect to organized crime, Latin America civil rights expert Edgardo Buscaglia claimed, "They realized they could compete to capture different state territories; compete with corruption; compete with violence that began little by little in the era of Zedillo (president of Mexico during 1994-2000) until the gradual escalation of violence." The result of a freer, decentralized democracy under weak, vulnerable, or corrupt institutions was greater uncertainty and instability throughout the system; a characteristic which also led to larger violent non-state actors to challenge the state or control it through corruption. Incidentally, a pronounced jump in corruption mirrored by a swift drop in inequality between years 2008 and 2010 also corresponds to the most violent and turbulent period of President Felipe Calderon's battle against drug cartels.

Dobson et al.'s conclusions with regards to anti-corruption measures' negative effect on the informal economy may also play a role in this corruption-inequality trend. Since corrupt practices were the modus operandi of official state structures for decades, many were either not viewed as corrupt *per se* or were simply deemed necessary for basic economic functions and supporting lower classes – this is true especially of the informal market, which supported 60% of Mexican workers in 2013[11]. For some of the poorest, bribing officials was simply an expedient form of taxation that *had* a tangible benefit: the right to operate. Heightened crackdowns on informal sectors and the "low-hanging" fruit in anti-corruption programs – often touted as swift victories against corruption by politicians - potentially exacerbated inequality by not providing other accessible economic avenues. This may have led to other mechanisms

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[11] Hughes, Krista. "Mexico aims to bring shadow economy into the light." Reuters. 25 Jun 2013.

which aggravated corruption but mitigated inequality, such as increased cooperation with organized crime. Similarly, cut-back on corrupt, low-level officials which in certain ways promoted redistributive measures may have led to a similar effect.

The most emblematic representation of Mexicans' resignation to corrupt, but predicable and stable, institutions was captured in one of the main slogans of the PRI's successful bid for the presidency with Enrique Peña Nieto in 2012 – "El PRI *sí* sabe gobernar" (The PRI *does* know how to rule). The popular belief was that since the PRI was the main architect of the corrupt schema underlying Mexico's political structure which the PAN was unable to successfully reform, the PRI was the best equipped to tame it. Given the high levels of violence and corruption, and disappointing economic growth under Peña Nieto, this belief seemed misguided and the prospects for another PRI term seem minimal.

Conclusions & Policy Implications

The cycle of corruption and inequality is not as straightforward as it may seem and may change, or even appear inverted, in certain structures or under certain shocks. This study finds a statistically significant *inverse* relationship between levels of corruption and inequality in Mexico after the year 2000, upon the PRI's loss of the presidency. This relationship, or any other for that matter, does not appear present in years preceding.

Given the shock that delivered the conditions for this paradoxical relationship, a likely explanation is that the PRI's loss of monopoly over power and opportunities for corruption allowed more players to enter and engage in "competitive corruption" which allowed greater avenues for mitigating inequality. The factors described in Dobson et al.'s study are closely tied to this dynamic - informal markets, which are an important source of income for the low and low-middle classes, rely on corrupt mechanisms to exist and thus, they may be negatively affected by anti-corruption measures or positively affected by competitive corruption.

Mexico's mechanisms of redistribution appear to be tied to corrupt structures and actors. As such, the economic survival of many of its sectors hinges on the continuance of certain types of corruption. As long as this is the case, appeals for a "culture of integrity" that rejects corruption may continue to be ineffective – especially as corruption at the top levels continues unpunished. If economic security depends on it, then incentives are too great to reject corruption altogether – "hard" measures are also ineffective and risk backfiring by squeezing opportunities at the bottom. What is needed is a strategy that realigns incentives – where corruption leads to more inequality and anti-corruption leads to less – and attacks the problem on two main fronts: 1) taxes must become much more effective at redistributing resources to the bottom and limiting evasion at the top levels – this may achieve higher credibility of government

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