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The Mexican banking sector:

A case study of distributional coalitions and state capture

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To Serg and Isa

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List of acronyms

ABM	Asociación de Bancos de México / Mexico's Banks Association
AMCB	Asociación Mexicana de Casas de Bolsa / Mexico's Stockbrokers Association
CCE	Centro Coordinador Empresarial / Business Coordinating Council
FOBAPROA	Fondo Bancario de Protección al Ahorro / Deposits' Insurance Fund
PNR	Partido Nacional Revolucionario / National Revolutionary Party
PRM	Partido de la Revolución Mexicana / Mexico's Revolutionary Party
PRI	Partido Revolucionario Institucional / Institutional Revolutionary Party
WC	Washington Consensus

Abstract

This paper studies the Mexican banking sector as a distributional coalition that engages in state capture in order to increase the income of its members. In doing so, it reviews the historical process from which the distributional coalition emerged, as well as it relation with the Mexican state throughout the 20^{th} century. The case study is centered on the banks' privatization process and their later bail out, which happened in the decade of the 1990s. It argues that the specificities and outcomes of both processes, which have imply the transfer of wealth from taxpayers to a small minority, can be understood in terms of the emergence and consolidation in Mexico of a financial distributional coalition and state capture.

Relevance to Development Studies

The banking and financial sector, a key component of any capitalist economy, is supposed to contribute to economic development and social wellbeing through the provision of financial resources to non-financial firms. However, many countries have witnessed how the financial sector incurs in excesses, producing capital losses and becoming a fiscal burden for many governments. The current global financial crisis and its effects on many states is a forceful example of this. By locating the development of the banking sector as a distributional coalition in Mexico's historical perspective, and reviewing in deeper detail the banks' privatization, bankruptcy and bail out happened in the 1990s, this paper intends to contribute to the understanding –and perhaps prevention- of the recurrent phenomenon in which a small financial elite captures immense amounts of society's wealth.

Keywords

Distributional coalitions, banking sector, finance, state capture, Mexico

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I. Introduction

1.1 Background

Since the banks nationalization in 1982, the banking sector in Mexico has gone through a process of de-nationalization, privatization, re-nationalization, and sale to foreign capital. In this sense, the constant of Mexico's banks contemporary history has been change and reform. However, given the recurrent crises and economic downturns to which the banking sector has contributed in the period studied in this paper, it could be argued that the reforms and changes have been insufficient or in the wrong direction.

Empirical evidence indicates that Mexico's financial policy outputs have implied tremendous benefits for a small group of people, while being detrimental to economic growth and population's well being. In this regard, probably the most deleterious experiences have been the banks' privatization (1991), bankruptcy (1994), and bail out (1995-). The aforementioned sequence of interrelated events –specially the banks' bail out- have cost to the Mexican State, whose half of the population lives in patrimonial poverty, around US $98 billion (Garrido 2003), and still today represents an amount of public debt equivalent to 13% of the GDP (Banxico 2007).

In the chain of events –all happened in the 1990s- different scholars have agreed on one continuum: while banks profits were kept as private, banks losses were socialized, turned into public debt and charged to taxpayers (Garrido 2003) (Haber, Klein et al. 2008) (Rosales, Birch et al. 2002). Even presently, the Mexican banking sector represents an outflow of resources from public expenditure –much needed in other areas as social development-, does not provide credit for private firms –or does it just in small proportion-(Banxico 2007), charges expensive commissions –earns as a risk taker while making conservative decisions-(Banxico 2008), and contributes to an increasing indebtedness of a poorly financially educated population (Garrido 2009).

Based on the aforementioned evidence, the question arises: how has it been possible for an small elite to consistently obtain policy outputs that disproportionally benefit them at the time that seriously affect the whole economy and the majority of the population? Seen from the other side, it can also be asked: why did the government have consistently agreed to benefit such a small group at the expense of the vast majorities? Given the aforesaid, this research has the following problem statement, objective and research questions.

1.2 Problem statement

This research intends to approach the problem of unfair allocation of resources within societies. In particular, it will look at the way financial elites have captured an immense share of wealth from the Mexican society. The temporal boundaries of the research refer to the decade of the 1990s, although the background will consider historical phenomena throughout 20^{th} century.

1.3 Objective

To contribute to the understanding of the process through which a financial elite –acting as a distributional coalition- has been able to capture an immense share of wealth from the Mexican society.

1.4 Research Question

Why and how has it been possible for a small elite to obtain policy outputs that disproportionally benefit them at the time that affect the whole economy and the majority of the population?

1.5 Sub-research questions

a) Which was the process through which the bankers became an important distributional coalition and which was their role in the context of the 1990s' banks bankruptcies and bail out?

b) How can we explain the shortcomings of the policy outputs regarding the banking sector in Mexico during the 1990s?

c) How can we explain the fact that public banks were privatized and sold for US $12 billion in 1991, and then bailed out a few years later for an amount of US $98 billion?

1.6 Hypothesis

The hypothesis of this paper states that the banks' mismanaged privatization and the procedures of its subsequent bail out can be explained in terms of a) the configuration and consolidation of a distributional coalition -integrated by banks' owners and the techno-managerial elite that governed Mexico during the 1990s-, b) the invigoration of state capture -exerted by the bankers-; and c) financial liberalization as a context that strengthened mobile assets owners , including bankers.

1.7 Dependent and independent variable

This paper analyzes as the dependent variable that seeks to explain the transfer of considerable amounts of society's wealth towards a small group of individuals happened in the 1990s. The paper argues that the explanatory or independent variable comprehends a financial elite that emerged and consolidated as a powerful distributional coalition within the Mexican state.

However, a precision is required. While a consolidated distributional coalition in the context of the 1990s is treated as the independent variable that explains the transfer of society's wealth towards the small financial elite, it is important to mention that this same distributional coalition (operating as independent variable in the 1990s) can be seen as a dependent variable of Mexico's historical development during the 20th century.

While chapter four provides an implicit account of the transition from dependent to independent variable (the origins, configuration and strengthening of the distributional coalition), chapter 5 offers an analysis in which the distributional coalition is no longer treated as the dependent but rather the independent variable.

1.8 Research methodology

This research intends to explain why it has been possible for a small financial elite to obtain policy outputs that disproportionally benefit them at the time that affect the whole economy and the majority of the population. Scholars have attempted to explain this from different perspectives, which include the path in which financial liberalization proceeded (Auerbach 2001); the institutional and structural characteristics of the Mexican economy (Garrido 2003); the mismanagement of policy decisions (Kantor 2003) and the pervasive effects of a neoliberal project (Ballesteros 2005).

However, and without dismissing the previous explanations, this paper complements the previous analyses by adding two notions with explanatory strength that explain an important dimension of the processes and outcomes surrounding the Mexican banking history. These notions are the ones of distributional coalitions and state capture.

In order to do so, this paper relies on secondary data. This includes literature on the state, distributional coalitions and organizations for collective action. It also reviews and analyzes what other scholars have written regarding Mexico's (and other developing countries) experience with the process of financial liberalization and its interplay with costs and benefits for different groups of society. . The paper also makes use of other kind of secondary data as newspapers, videoconferences and government reports.

In different degree, the paper applies the concepts of distributional coalitions and state capture to the history of Mexico on two different moments; the consolidation of the Revolutionary regime in the 1930s and the processes of economic reform towards financial liberalization happened in the decade of the 1990s.

1.9 Limitations

Historian Eric Hobsbawm considers the 1990s as the end of the 20th century. The disintegration of the USSR, the end of a bipolar world and the apparent victory of liberalism, democracy and capitalism as understood by the US seemed to modify international structures as well as the opportunities and constrains facing many nation-states. These changes have a relation with the strengthening of financial capital throughout the world and its post 1989 configuration concurs with the period studied in this paper. However, given the focus of analysis and the length constrains, this study does not includes a discussion on the relevance that such changes in the world system had for countries as Mexico.

On the other side, Mexico joined NAFTA in 1994. With regard to the banking and financial sector, both the negotiations and the outputs around this treaty can be very enlighten and have had undeniable structural consequences for the future development of the sector. However, in order to maintain an in-depth analysis from the chosen perspective –distributional coalitions-, this paper does not discuss the implications of Mexico joining NAFTA.

It has to be mentioned that an in depth-discussion and analysis of financial liberalization is not provided; rather, only a brief description of the main characteristics, the theoretical underpinnings and the way it can favor mobile assets owners is included. In addition, the transition towards an electoral democracy that Mexico began in 1976 and concluded in 2000 is neither considered.

Finally, this study does not make use either quantitative analysis or primary data; given the time and financial constrains faced during the research process, this study is based mainly on secondary data.

1.10 Structure of the paper

In order to develop the argument, this work is divided in 6 chapters. After presenting a general overview –including the objectives, research question and research methodology in the first chapter, the second chapter makes a literature review on what scholars have said regarding the pervasive effects of policies and liberalization in Mexico. The third chapter presents the theoretical framework that helps answer the research question; these include the concepts of state, state capture, organizations for collective action and distributional coalitions. The fourth chapter **analyzes** the configuration of the revolutionary regime as well as its main characteristics in terms of the distributional coalition underpinning it. In addition, it provides an implicit account of the financial elite's transition from dependent to independent variable, tracing the origins, configuration and strengthening of a new (financial) distributional coalition that latter would substitute the one inherited from the revolution. The fifth chapter **analyzes** how the bankers acted as a successful –even if highly pervasive- new distributional coalition that, it is argued in this paper, underpinned the way banks' privatization and bail out happened. In this sense, while chapter four sees the configuration of the financial distributional coalition as dependent variable of Mexico's historical development between the 1940s and the 1980s, chapter five considers this -already consolidated- coalition as the independent variable explaining the specificities of the bankruptcies and bail out in the 1990s. Finally, the sixth chapter presents the conclusions of the paper.

Chapter II Literature review

In order to understand and explain the process and negative effects of financial policies (including financial liberalization) in Mexico, some scholars have put the emphasis on international conditions as the monetary system, which increases mobile capital owners' power and favors the road toward financial liberalization; such a process in Mexico is seen from this perspective mainly as a consequence of the world economic system and the road of capitalism.

In this sense, and from Marxian perspective, for example, Nora Hamilton (Hamilton 1975; Hamilton 1984) raises the question of State's autonomy when analyzing the economic crisis and the banks' nationalization in the early 1980s. She argues that as the State loses the ownership and control of the means of production, power begins to be executed by the economically dominant classes, thereby challenging the assumption of the State as an entity that acts autonomously from other societal forces (Hamilton 1975). Furthermore, she argues "the fact that the state is embedded in a given class and international structure limits its propensity for decisive action toward change of existing structures" (Hamilton 1984:7).

Hamilton concludes that rather than the State, "class and group interests, alliances, and conflicts (…) functioning within the state or outside of it, constitute the decisive actors in the process of change" (Hamilton 1984:7). Therefore, from her perspective, the financial policies outputs can be explained due to the fact of a state that does not act autonomously to safeguard the common good and rather, it reflects the decisions of the economically dominant classes, in this case, the capitalist faction that will profit from the financial sector liberalization (which eventually can be represented by both domestic and foreign capital).

Nonetheless, from a different perspective, which also recognizes the international constraints imposed by the international economic system but assumes the existence of an autonomous state, the negative effects of financial policies in Mexico can be better understood analyzing the structure of domestic politics. Many of these accounts depart from the acknowledgment of a strong autonomous state in Mexico, whose institutions or actors (the presidency, the bureaucracy) can be differentiated from other social groups. In contrast to Hamilton's approach, this perspective assumes an autonomous state whose interests and preferences are not necessarily the same as of those who posses the means of production.

Regarding the aforementioned, Maxfield and Haggard (Haggard and Maxfield 1996) argue that the process of financial policy on liberalization in developing countries (materialized by the opening of the capital account), responded to both pressures at the international level -economic interdependence and financial integration as background- and conjunctures in the domestic structures of power, which interplay with the worldwide trend. In particular, they see balance of payments crisis as the proximity cause of capital account opening or financial liberalization1 in countries as Mexico, Korea and Chile.

From their perspective, the autonomous state -embodied in the main policymakers- decided to agree on financial liberalization due to three factors: the increasing costs of capital regulations imposed by international financial integration; the desire to attract foreign capital and the need to provide confidence to investors; and the convergence or initiative of private actors at the national level –often leveraged on the exterior- who would benefit from a certain kind of liberalization (Haggard and Maxfield 1996).

However, in contrast to Hamilton's analysis, Haggard and Maxfield have an autonomous state-centered approach and base their analysis on the actions and preferences of the government. Furthermore, based on the strength and autonomy that has characterized the executive power in Mexico, their model assumes –even if implicitly- the state as a unitary actor –in this case, embodied in the president.

In more recent times, Auerbach (2001) has developed a comparative analysis that also builds upon previous academic work but that additionally, proposes a focus on the changing strategic interaction between public officials or the autonomous state and private actors participating in the market. She studies Mexico's tortuous transit from a state-led to a bank-led and eventually market-led financial sector. In order to understand the direction (and costs and benefits) of financial policies in Mexico and developing countries alike, she argues, one must bear in mind the dynamic interaction between government and the banks.

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[1] The authors do differentiate between liberalizing the flows of capital and liberalizing the entry of foreign intermediaries.

In this sense, Auerbach recognizes that circumstances and preferences are not static, therefore, she argues, the analysis of the relation between banks and government over time requires being able to introduce the element of changing conditions in the structures. For example, "private banks' share of resources increased from 35.9 percent in 1940 to (...) 62.6 percent in 1991", which eventually modified the balance of power and therefore the financial policy (Auerbach 2001:33). Indeed, as is to some extent the case of Mexico, the relation between banks and government can vary even throughout the process of financial liberalization.

Principally, the power share between state and banks within the financial market structure, which influences both parts' preferences, determines the dynamic relation between both as well as the financial policy produced by it. In other words, financial policy is to a large extent caused by the way the state and banks interact in the financial sector: in this sense, the path towards financial liberalization in Mexico was underpinned by a shift from a state-led towards a bank-led financial sector2, or, in words of Auerbach, to "the rise of bankers hegemony" (Auerbach 2001).

In this sense, the process and outcomes of financial policies, in terms of its induction towards economic growth or economic crisis, were determined by the interests and increasing power of its promoters (an un-competitive bank-led financial sector), as well as the relative loss of state autonomy, which was no longer able to direct the financial sector according to it preferences (economic growth). The aforementioned provides the basis for a financial liberalization policy mix that benefitted the interests of banks rather than economic growth or the common good.

Although Auerbach' analysis provides great insight into the politics of financial liberalization, and shows the role and importance of market structure (between state, banks and industry) as a causal explanation for the breath and scope of financial liberalization in Mexico, it fails to address the existence of divisions or factions within the financial industry, or in other words, it fails to identify the existence of actors with different political interests. Regarding the aforementioned, Susan Minushkin work (Minushkin 2002) provides powerful explicative elements.

[2] Auerbach argues that is better to liberalize the financial sector when it is still state-led, because its hegemony or relative strength allows the state to shape the process of financial liberalization according to the requirements of economic growth and common good, rather than the interests of the financiers (Auerbach 2001). I share her view.

In her co-authored work about financial liberalization in comparative perspective (Lukauskas and Minushkin 2000), it is argued that the path towards financial liberalization is determined to a large extent by the countries' economic conditions and need of funds, which defines its bargaining power with foreign and domestic actors regarding financial policy.

Furthermore, in her later paper (2002) she highlights how diverse groups integrated the financial industry in Mexico: mainly *bolseros* –stockbrokers- and *banqueros* –bankers-, which though united by the economic realm of their activities, differed in their established political alliances, or, to be more specific, differed in their relationship with the presidency.

In this sense, Minushkin work improves Auerbach in that while the latter gives a unitary treatment to the financial industry –represented by "the banks", the latter provides the elements to distinguish between different economic groups within the sector, as is the case of the banking and the securities market.

The present work considers the insights and debates provided by the aforementioned scholarly work. However, it takes a different stand regarding the perspective and the focus of analysis. This is so given that even if the reviewed literature is useful, it fails to provide an account of the high degree of collusion that existed between the authorities –representatives of the state- and the bankers that as an organization for collective action, and acting as a distributional coalition, were able to capture unprecedented amounts of Mexico's wealth.

Chapter III Theoretical Framework

3.1 Introduction

This chapter will elaborate the theoretical framework that will help to answer the research question leading the paper. First, it provides certain considerations regarding the notion of the state as an historical construction and an institutional landscape with strategic implications. Then it develops the concept state capture, including the motives and the methods through which firms capture the state. Finally, it elaborates on Olson's logic of collective action, highlighting the advantages that small groups have in this regard and the historical circumstances that facilitate the emergence of new distributional coalitions.

3.2 The State

The state is a contended abstraction around which different perspectives and interpretations exist. However, this work will try to provide an operational definition of what it means by state so it is then possible to introduce and better develop the idea of the captured state. In a legal sense, we could speak about the state as an entity comprising a territory and a population bounded by a juridical link. Historically it is possible to argue that a somehow form of state appeared since the old Mesopotamia, around 3000 years B.C. However, it was not until the 17th century's Peace of Westphalia that the term state and state sovereign began to be used.

According to Oxford's dictionary of politics the state is a "distinct set of political institutions whose specific concern is with the organization of domination, in the name of the common interest, within a delimited territory (…) The development of the modern form of the state, as a public power separate from the monarch and the ruled, and constituting the supreme political authority within a defined territory, is associated with the slow institutional differentiation of the ¨political" and the "economic" related to the growth of the centralized absolutist state and the spread of commodity production"(McLean and McMillan 2003: 512,513).

In one of his masterpieces, *The profession of politics*, Weber conceives the modern state –a man-by-man domination as all the political entities that preceded it- as "a human community that successfully claims for itself the monopoly of the legitimate use of physical violence within a territory with determined boundaries". Weber notes that with the development of the modern state it also comes the development of a new social category, that of the bureaucracy, which carries out the state's administrative tasks. In the case of Mexico, and particularly after the Revolution, this bureaucracy not only carried the administrative tasks but it also functioned as the body through which political conflict was processed. However, a final point that Weber notices is important: the alienation of the administrative staff in the sense that, contrasting with previous political entities, under the modern state the material means of administration no longer belong to those that carry it out (Weber 1989:2,7).

In spite of the aforesaid, it is important to bear in mind that in practice, the state makes reference to both, an institutional and a historical contextualization. With regard to the institutional one, this means that the state can be seen as the context in which political actors carry out their activities; under this structural-institutional perspective, the state provides both opportunities and constraints to political agents; the state then is the institutional landscape within which actors have to negotiate (Hay and Lister 2006). In this sense, the transformation of the state will have consequences in the options available to the political actors.

In addition to the need of "contextualize political agency and agents institutionally", it is also important to "contextualize the present historically". This refers to the fact that what and what does not happens in the context of the state is not a product of spontaneous generations or individual voluntatirsm solely. The state reflects not only the political actors' preferences only but also a legacy from the past (Hay and Lister 2006:13). Therefore, when analyzing a given situation, it is important to keep in mind the historical processes through which it was arrived to that situation. That is why when explaining the banks privatization and bail out, this paper goes back in history and traces earlier developments in the Mexican state.

On the other hand, other perspective useful to this work is offered by Jessop, whom not only paraphrase Weber on his preliminary definition of the core of the state as "a distinct ensemble of institutions and organizations whose socially accepted function is to define and enforce collectively binding decisions on a given population in the name of their common interest" (Jessop 2008:9), but also introduces the notion of the State in terms of an strategic-relational dimension. This refers to the fact that, the state as the landscape in which political actors make decisions is not strategically neutral, but rather discriminatory in that it tends to be more conducive to certain strategies and actors' preferences than to others (Jessop 1990:10). In the case of Mexico then, it could be expected that the state from the 1940s privileged different options from the one in 1990s.

Regarding the aforementioned, it is important to bear in mind the following considerations (Jessop 2008:9-11):

1) Underpinning the state there are institutions and organizations whose relation to the ensemble is not certain, therefore, institutional orders and systems change over time (as the institutions and organizations underpinning it do);

2) The nature and history of social formations influence the nature of these state institutions and the way the latter relate to the former. In this sense, for example, Mexico's revolutionary regime had experience more than a decade of war and two million deaths, which it lead it to create the institutions and social relations able to provide stability and social justice -as a way to prevent new social upheavals;

3) Legitimacy can be expressed and institutionalized in different ways, depending on what is socially acceptable; in other words, regimes can differ in their forms and foundations but share the legitimacy component. In the case of Mexico, although the Revolutionary regime was authoritarian and allowed for economic inefficiencies, it was still legitimate because it delivered social welfare.

Concerning the behavioral or strategic dimensions of the state, these include three: the first one refers to the social bases of the state, the groups and interests whose agreement laid down the basis over which the state is design and established. As the groups included in the agreement change, it can be expected that the behavioral and strategic dimension of the state (how privileges some outcomes above others) will also change. In this case, it can bee expected that a state based on the agreement of organized labor, peasants and domestic industrialists (as Mexico after the Revolution) will behave different from one in which the ´social bases´ are conformed by export oriented firms and financial capital (as Mexico in the 1990s).

Also concerning this dimension its important to bear in mind "the state practices (…) operational procedures, means of coordination and guiding purposes". Finally, the third component relates to the ideology encompassing the general will or common interest that the state is supposed to take care of; the latter offers "political, intellectual and moral guidelines for the conduct of state policy" (Jessop 1990:346).

In conclusion, the state is an entity established to promote and guarantee society's common good. The state also functions as the historical and institutional landscape constraining and providing with opportunities to the political actors. However, it is not a neutral entity in the sense that it tends to privilege some outcomes and actors over others.

3.3 State capture

The origins of the state capture theory can be traced to Marx's view in the sense that the owners of capital are those that control and command what the state does. Later on, a Weberian or neo-Weberian approach was also developed by 20th century political scientists, basically referring to the role that private interests -specific firms or industries- can have in public policy (Laffont and Tirole 1991:1089). Although this paper adopts an approach closer to the latter when defining the state (see section 3.2), it is important to stress the tensions between the two perspectives and to consider some insights from the Marxist one that contribute to the argument that this work intends to develop.

In principle, the Marxist perspective rejects the claim of an autonomous state and argues that there is always a degree of capture. Whether as a repressive arm of the bourgeoisie, an instrument of the ruling class, an ideal collective capitalist or as the factor of cohesion that preserves class domination (Hay 2006), the State is seen not as an autonomous but rather as a dependent or captured entity.

However, Marxist perspectives and scholars also offer insights that support the approach taken by this paper. It is the case of for example the clarification offered by Miliband in the sense that there is an "important distinction between governing (making day to day decisions) and ruling (exercising ultimate control)" (Held 1989:67). So, accepting the state has the mission of preserving a given mode of (capitalist) production does not imply denying the possibility of a (bureaucratic) governing group different –even if also interdependent- from the dominant economic class.

Furthermore, there is Poulantzas' claim in the sense that dominant classes are subject to division or fragmentation and therefore need state's protection for their own survival. Nonetheless, the state can provide such protection only if enjoys some degree of relative autonomy, which ultimately "depends on the relations among classes and class fractions and on the intensity of social struggles" (Held 1989:69).

Poulanrzas statement –that state autonomy depends on the class relations and the intensity of social struggles- is specially important if combined with Miliband's assertion in the sense that under exceptional circumstances –specially national crises and war- the state can reach a high degree of independence from class interests (Held 1989:69,67). As will be showed in chapter four, such is the case of the state inherited and constructed from the Mexican revolution, and that is why this paper adopts an approach in which the state is granted with autonomy.

According to the aforementioned, the notion of state capture developed hereafter is narrower than what the Marxist perspective would propose, assuming throughout the paper the state as an autonomous entity but without necessarily relegating or marginalizing political forces outside of it. Rather, the implicit neo-Weberian approached assumed here accepts an interplay between the state and other societal groups, including capitalists factions acting as distributional coalitions.

Having considering some insights from the Marxist perspective, let us now provide an operational definition of state capture. In accordance with the neo- Weberian argumentation developed in this study, a more modest definition of state capture should be taken, and refers to a dynamic relationship between firms and the State in which the latter stops fulfilling its mission as guarantor of the public interest and the former entrench within the political system to an extent that shape "the formation of the basic rules of the game (i.e. including laws, rules, decrees and regulations) through *illicit* and non-transparent private payments to public officials." (Daniel Kaufmann, Hellman et al. 2000:3).

3.3.1 How and for what reasons do firms attempt to capture the state?

In principle, firms attempt to capture the state for the very same reason of their existence: profits. In capturing the state (understood as the firm's ability to define the basic rules of the game in any given process or industry), firms are seeking to increase their profits through non-competitive means. In this sense, firms look to influence laws, rules and decrees in order to guarantee for themselves a higher rate of return, but rather than through increase efficiency, through the cooptation of public institutions responsible of defining the regulatory frameworks under which firms will.

It must be borne in mind that "the state (…) is a potential resource or threat to every industry in society" (Stigler 1971:3), which means that the state disposes of means to define both winners and losers of different policies, markets and industries. Among other things, the state can impose taxes, give subsidies, set prices and, very importantly, modify the law, all of which can translate into benefits for certain actors instead than others.

Additionally, then, it must be specified what policies will firms usually seek from the state. According to Stigler (Stigler 1971:4-6), there are four main state policies from which firms will seek to benefit (put it in another way, there are four main policies that motivate the capturing efforts).

First, firms may look for monetary subsidies. This refers to monetary transfers from the state to an industry; in order for this policy to be attractive to firms, the number of participants or stakeholders in the industry should be kept low. Otherwise, the benefits will dilute at the individual firm level. As will be shown in chapter five, the bail out to Mexican banks in the 1990s accounted for a hidden subsidy to the owners of this industry.

Second, firms engaging in state capture may also look at entry barriers of new firms. The discouragement of new competitors is an important element in giving firms more than competitive rates of return. This was the case governing Mexico's banking sector during the 20th century and specially, the non-banking financial industry since the early 1980s until the late 1990s. A third set of policies is related to substitute and complementary goods; firms may tend to promote the support of complementary industries and the weakening of substitute markets. Finally, the fourth policy refers to price fixing. These last two were not clearly present in Mexico.

In short, to the question of why it can be answered that firms try to capture the state because the latter –or whomever that controls it- is entitled with the right to coerce, therefore being able to legitimately assign costs and benefits among different sectors of society. To the question of what for, the answer is straightforward: firms try to shape state's action in order to get higher profits.

3.3.2 How do firms capture the state and why do state representatives collude with firms?

Firms have different forms of influencing public policy, which include monetary bribes; promises of future employment opportunities and personal relationships which make the public officials or agencies to provide special favors to the firms. Firms can also menace or abstain from public criticism or campaigns against government agencies. Finally, firms can influence the decision through transfers to appointed and elected officials in strategic public posts, whether through monetary support for political proselytism (e.g. financing electoral campaigns) or through widening the electoral base (e.g. inducing the firms' employees preferences) (Laffont and Tirole 1991:1090,1091). In short, as Stigler put it, the "industry which seeks regulation must be prepared to pay with the two things a (political) party needs: votes and resources" (Stigler 1971:12) This was specially the case in Mexico during the 1990s, when the hegemonic party saw his electoral supremacy challenged for the first time in the 20th century.

As the aforementioned paragraph suggests, public officials collude with firms because they also expect benefits in return, which can be monetary or political in form. It must be considered that certain firms or industries can have tremendous power that can effectively influence a public servant's permanency in office. Paraphrasing Stigler, a politician will not find it easy to win an election based on the support of those that oppose certain industries' subsidies. In contrast, if powerful industries (from TV corporations to big landowners) unite against a politician, most probably he will find it difficult to get reelected or to resist pressures for his removal. The previous considerations are related to the organizational cost and the logics of collective action, which will be outline in the next section.

3.4 Why do certain groups have higher chances than others to capture the state?

3.4.1 The "logical" reasons and their implications

The question raised above refers us to the problems of collective action, and in order to answer it this paper will make use of one of Olson's masterpieces *The logic of collective action: public goods and the theory of groups* (for a critic of Olson's arguments, see Cameron 1988). Given that a comprehensive study of the logics of collective action surpass the purposes of this work, I will focus on highlighting why smaller groups can be more effective than larger ones when it comes to get organize and reach a common interest.

According to the arguments developed in Olson's work, the traditional view that sees groups as the natural consequence of human nature presents shortcomings when contrasted with empirical evidence. Groups are indeed part of mankind, however, there are differences to bear in mind when it comes to which will get organize, why and how.

First of all, it is important to note that the achievement of a common goal by certain group implies the provision of a collective good for that group (Olson 1971:17). Take as an example a labor union that gets a minimum wage law; an industry that gets a policy such as a protectionist tariff; or imagine a group of citizens that gets safety and security given the presence of an authority. Additionally, based on *The logic of collective action*, it is possible to reject the intuitive or traditional idea that any single group (of individuals with shared or common interest) will carry out the necessary activities to increase their benefits. Furthermore, the larger the number of group members, the smaller their possibilities for effective voluntary collective action.

The aforementioned is true given the fact that different groups face different cost functions when it comes to their collective action. Lets consider a consumer who faces more than competitive prices in any given product; he would be part of the larger group of people affected by the higher prices of that good. However, if he wanted to organize a consumers association in order to modify the regulations that allow for higher prices, then, he would need to incur in high costs. To begin, there will be high initial or fixed costs(Olson 1971:22): he would need to spend financial resources in organizing the other consumers; additionally, he would need to give up much of his free and working time devising the strategies and organizing the activities required to persuade the authorities, etc.

Even further, in the case that after years of struggle he were successful in achieving lower prices of a given product, then he would face the reality that all consumers –including all those that denied to contribute on the cause- would enjoy the benefits product of the struggle that himself carried out. In other words, he would face a big free-rider problem.

On the other side of the equation, let's assume an industry with a few members that pursue the common goal of reaching higher prices for their product. For sure they would face collective action problems, but ones that would be easier to overcome. Oppose to what can be expected of a large group –where the benefits of a collective good tend to dilute among a high number of members-, for a small group it could even be the case that some members would be better off if the collective good their looking for is provided, than they would be if it were not provided, even if they had to pay the entire cost of providing it themselves (Olson 1971:33,34).

When analyzing collective actions problems, it can be advisable to analyze their inclusive or exclusive nature, as well as if they are acting within market or non-market contexts (the same group can actually be situated in more than one case depending on time and space) and the incentives individual members face. However, for the argument of this thesis, I will limit myself to conclude by saying that, as already mentioned, the smaller the group, the higher its chances to get organize and achieve the provision of a collective good that serves their particular interests (Olson 1971:36). In other words, small groups "have disproportionate organizational power for collective action" (Olson 1982:74).

3.4.2 The historical reasons

As mentioned in section 3.1, states must be contextualized historically; they are not only the byproduct of current actors' preferences but also reflect legacies from the past. In this sense, it is important to consider that actions of different groups occur through time and can influence social change. In order to outline some important considerations regarding the way potential state capturers operate within the pass of history, this research will make use of Olson's later work, *The rise and decline of Nations*.

If on *The logic of collective action* Olson disputes the traditional account of collective action as a natural result of a group shared interests (e.g. Marx's proposition that the proletariat will take conscious of their class condition and act to advance their interest), in his later work Olson develops the argument from an historical perspective in which applies his analysis to explain why similar countries present different rates of growth.

Olson argues that the logic of collective action has some implications. For the purposes of this work, it is convenient to highlight the following. First, as already notice, given that smaller groups have an advantage over larger groups when it comes to collective action, then, countries will face a non-symmetrical organization of all the groups (with shared interests) present in the country, therefore there will be different bargaining power (Olson 1982:37).

A second conclusion which may seen obvious but it is not, is that the more stable a regime, the more organizations for collective action will emerge and attempt to collude in order to get collective goods for their own benefit (Olson 1982:41). Through their interaction with the state, this organizations for collective action established as distributional coalitions, seek to capture rents for themselves without regard of the cost that their action has for economic growth and social welfare.

While social upheavals –as the Mexican Revolution- end up with previous distributional coalitions, when a regime experiences long periods of stability, new distributional coalitions begin to emerge again. This can continue until there is again a Revolution that set the foundation for a new regime in which, eventually –and if stability allows it- new distributional coalitions will emerge.

In this sense, we can define a distributional coalition as a group or organization for collective action that seeks to further the interests of their members', and in doing so it tries to increase the wealth received by its members. However, a final consideration is required: the smaller the distributional coalition, the more it will look to increase its share of wealth rather than to increase the total amount of it. This is the case of the financial elite in Mexico. In contrast, the more encompassing the organization, the more it will look after increasing output (rather than just get a bigger portion) as otherwise it could not fulfill its mission of increasing the members' interests or wealth.

3.5 Conclusions

Although the state is a contended abstraction, there seems to be agreement on the fact that its main objective is to safeguard the common good. Additionally, it is important to conceptualize and analyze the state as an historical construction, a present reality embedded in the legacy of the past. Also important is to acknowledge that the state functions as the institutional landscape in which political actors make decision. However, the latter does not happen in a neutral manner in the sense that as an historical and institutional setting, the state tends to privilege some outcomes and players above others, therefore being infused with a strategic dimension.

Initially, state capture could refer to the use of the state by the owners of capital. In this paper it can be understand as a situation in which the private organizations –usually firms- shape and influence the "formation of the basic rules of the game (laws, rules, decrees, and regulations, etc.) through illicit and non transparent private payments to public officials" (Daniel Kaufmann, Hellman et al. 2000:3). Firms tend to capture the state in order to increase their benefits, which can come in the form of subsidies, monetary transfers, entry barriers, etc. Firms have different forms of influencing the state (and policy making), which include, among others, monetary bribes, financial support for electoral campaigns and future employment opportunities.

In capturing the state, small groups face, in contrast to larger groups, a cost function that facilitates them collective action. Initial costs tend to be smaller, coordinating procedures are simpler and benefits usually higher. Groups with limited membership will organize in a more voluntary or even spontaneous way than larger groups. Additionally, the more encompassing the membership, the more the organization will procure to increase the output that is to be share; in contrast, the less encompassing the group, the less it will care for increasing total output and instead will focus its energies on acquiring a bigger share of the social pie.

Groups and organizations for collective action are intended to increase the benefits of their members. Therefore, groups can become distributional coalitions in the sense that they look to increase the wealth that their members receive. When a society in a given state experiences long periods of stability, distributional coalitions have higher changes of emerge, consolidate and act effectively. As the following chapter will try to show, such was the case of Mexico during the 20th century.

Chapter IV Mexico after its Revolution

4.1 Introduction

This chapter briefly analyzes the historical construction of the 20th century Mexican state, outlining the main characteristics that it had as the institutional and strategic landscape in which political decisions were made. In doing so, it mentions the implications in terms of distributional coalitions and state capture. Additionally, the chapter reviews the history in the relation between the bankers and the government in the decades previous to 1990, identifying elements that helped the former in becoming a hegemonic player within the state.

4.2 The Mexican Revolution and the new state

The development of the banking sector in Mexico can be traced back to the 19th century. Among other social struggles, Mexico experienced a civil war between so called liberals and conservatives during that century (the "three year war" 1867-1870). While the later supported a state based on corporations and the pre-eminence of church and privileged classes, the former supported a democratic secular project, based on the pre-eminence of the State over the church and the individual over the corporations. The triumph of the liberals –leaded by Benito Juárez- and the reforms taken since, signaled the first serious commitment of the Mexican state towards a capitalist economy (Leal 1975). Since then, this broader commitment with capitalism has never been seriously treated by the political coalitions governing the State.

The period that followed the triumph of the liberals in the late 19th century was not absent of contradictions, and the alliances that emerged from and build upon it, lead to the creation of a regime characterized by Leal (1975) as Liberal-Oligarchic. The alliance between those with a clear project of a Liberal Nation-State and a new group of landowners (produce of the expropriation of ecclesiastic goods and the dismantling of indigenous communal lands) engineered an apparatus which had the main tasks of guaranteeing national cohesion and creating the previously inexistent capitalist relations of production.

However, with the Mexican revolution (1910-1920), a new regime –based on the hegemony of the State and its bureaucracy – emerged. The armed struggle ended with the state apparatus developed by Porfirio Díaz (dictatorship of Mexico from 1880 to

1911). By 1912, there was not federal army, no judges, no police, no State. At the same time, the different forces involved in the social and armed struggle (from northern aristocrats and bourgeoisies to peasants from the south) were unable to propose and execute a national project, and therefore, an economic system.

The correlation of forces emerging from the Revolution favoured political-military power over the power of capital and labour. While the bourgeoisie (traditionally an ally of the previous regime) had lost its capacity to direct the Nation's destiny, and the working class had not yet developed the power to replace it, the military leaders (and the revolutionary armies/factions they commanded) found themselves with increasing power and independence in relation to other economic and social actors (Leal 1975b).

> "(T)he situation of catastrophic balance which provoked the revolution of 1910 made possible the hegemony of a specific social category, and not of a social class or class faction. (…) This hegemony (...) was not an automatic result of the situation in question; to a great extent it was also the product of the political action of the very same bureaucracy. (...) The bureaucracy indeed worked at establishing its hegemony" (Leal 1975b: 53-54).

In short, the Mexican Revolution led to the creation of a new somehow Weberian state in which the hegemony was exerted by a bureaucracy that conceptually (sometimes materially, some others just apparently) stood above the interests of the different social classes, therefore being able to reach class reconciliation. In order to do so, the State not only created corporatist organizations and tripartite bodies, but also ascertained the monopolist ownership of the nation over strategic resources (as oil and minerals) and sectors (as the energetic one), in this way limiting the expansion of private property, the power of capital and reasserting the supremacy of the bureaucratic state.

The instrument to stop violence and guaranteeing institutional continuity was the creation of the Revolution's political party, which emerged as the political system itself. In this context, "the social classes receive their recognition and organization, directly and expressly from the State" (Leal 1975b: 55).

The "state born of this scheme of contradictory interests has three characteristics which stand out above all other: a representative democracy, a presidential dictatorship, and corporatism" (Leal 1975b: 54). This political system, embodied around the continuum of the National Revolutionary Party (1929-38) - Party of the Mexican Revolution (1938-46) - Institutional Revolutionary Party (1946-) was a highly centralized structure with the presidency of the Republic at the peak of the pyramid, and governed Mexico without interruptions until 2000.

Finally, it is important to notice that the authoritarian character of this regime[3] and the lack of electoral competition provided little or none incentives or needs for public functionaries to engage or allow a high degree of state capture. This is not to say that there was not collusion between bureaucrats and private firms, but rather, that an strong state and a weak private sector is less susceptible of state capture than the other way around (Tang and Hedley 1998). Or, as Miliband asserts, an autonomous state can emerge under certain exceptional circumstances, which appears to be the case of Mexico during the decades that followed the revolution.

4.3 The Institutional Revolutionary Party as a distributional coalition

The *priísmo* was an extended social and political pact: for decades, Mexican presidents –all *priístas*- understood their call as administrators of that social and political pact; they were recipients of a wide range of contradictory demands that required tutelage. The president was the keeper of the inherited equilibriums: "the hegemony was dressed with the suit of an empire, but it was based in a baroque device of equilibriums and compensations. Undoubtedly authoritarian. But it was an authoritarianism obsessed with the search of consensus."(Márquez 2009)

According to the aforementioned, the PRI was a very encompassing organization: peasants, labour, industrialists, popular sectors, intellectuals, the emerging middle classes were direct or indirect members and/or beneficiaries of the PRI, which for most of the 20th century acted as a political system in itself. As theory predicts, then, the PRI, as an encompassing organization focused its energies –at least for several decades, while it was

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[3] The authoritarian nature and all encompassing aim of the regime began to change in 1976, under a serious of political reforms initiated by president López Portillo, directed to inject pluralism in the political system. That year is seen as the beginning of a democratic transition –in electoral terms- which concluded in 1997 and became obvious in 2000 when the revolutionary party lost the presidency. See Woldenberg, José "La mecánica del cambio politico en México", Cal y Arena, 2000.

the main organization for collective action- in increasing the size of the social cake rather than in just getting a bigger share for its members –as a non-encompassing organization could be expected to do.

It has to be mentioned that since its foundation in 1929 and until the 1980s, the political system embodied around the Institutional Revolutionary Party (PRI) went through changes and transformations. However, main aspects remained the same: a presidential system of government without genuine checks and balances nor autonomy from the Legislative and the Judiciary; a non-competitive electoral regime of quasi-unique hegemonic party (the PRI, which to a large extent constituted the system itself), with strong corporatist structures and clientelistic practices; and, a presidency holder of meta-constitutional powers and located at the peak of a highly centralized political regime.

In conclusion, the Mexican Revolution lead to a system from which a hard-to- capture strong state emerged. The machinery of the state was embodied around the party of the revolution, which not only had the ability and ableness (Barry 1989) to enforce its decisions even against the will of private interests, but that was also representative of many societal sectors and groups. If conceptualized as a distributional coalition in itself, it could be argue that after the 1910-1920 revolution the Mexican state–or to be more precise, the party of the revolution- was an encompassing organization for collective action and acted as such. That is, placing the emphasis of its activities on increasing output –and the common good- rather than in just getting a bigger share of the cake for its members.

4.4 The foundations of economic development after the Revolution

Considering the historical context describe in the previous sections, the encompassing aspirations of the revolutionary party, and the circumstances of capital scarcity once the revolution ended, the State assumed the role of capitalist, controlling the financial sector and allocating capital to priority sectors. Similar to what Gershenson describes for Russia, the State was the only entity capable of providing a pattern of capital accumulation directed to industrialization.

In this sense, since the consolidation of the Revolutionary regime in the 1940s, a model of mixed economy under state rectory provided economic growth. The accumulation scheme subordinated market logics as competitiveness and efficiency to state regulation. Equally important were the state ownership of the natural resources (oil, minerals, coasts, etc.) and the prohibition of private investment in strategic sectors (energy, oil industry, etc.).

Through public deficit and spending, the state articulated a highly concentrated internal market protected from foreign competition. This system set the ground for industrialization and enlarged the middle classes, but it also lay down the basis for the development of public and private oligopolies (Garrido and Puga 1990:43), which, as will be shown in later sections, eventually got empowered to an extent that were able to capture bigger shares of the national wealth without contributing towards economic growth.

It is precise to mention that the model of economic growth embodied around import substitution industrialization facilitated policies that on one hand promoted employment, high wages and social security, and on the other, delivered rents to the business class in the form of tax exemptions, subsidies and oligopolies (Garrido and Puga 1990:44). In this sense, it also implied that capital –entrepreneurs and businessmen- would abstain of participating in partisan politics, at least publicly. In terms of distributional coalitions, it could be say that the model took care of economic growth, development and delivered wealth to an extensive portion of the population.

In spite of the aforementioned, the stability that distinguished the Mexican regime –in contrast to most of Latin America- during most of the 20th century, also allowed different organizations for collective action –new distributional coalitions– to develop and gain strength. Such was the case of the bankers.

Additionally, the ISI model began to show signs of exhaustion since the 1970s. On one hand, there was financial strangulation due to economic imbalances produced by irrational foreign borrowing, inflation and unsustainable public deficit. On the other, there was increase confrontation between the business sector –specially the banks- and the government sector, particularly the president. The aforementioned, combined with changes in the international economy, increased pressures for structural changes, including financial liberalization, which eventually provided the benchmark in which the bankers colluded with a new type of government officials –the technocrats- and, through what has been called "state capture", diverted for themselves a huge portion of Mexico's wealth, disregarding the social and economic costs.

4.5 The origins of industrial subordination to financial capital

This section traces the origins of a new business structure in Mexico from which industrial financial conglomerates emerged, and that it is in the roots of the eventual subordination of industrial to financial interests. In doing so, it considers changes occurred in the banking sector originated in the 1970s that proceeded until nowadays.

An important change happened during that decade is that since 1974 but more formally and intensely since 1976, the government promoted the creation of the "banca multiple" or universal banking, which was suppose to attract and being able to offer a different set of services (mortgages, credit, financial services, deposits, etc.) as opposed to the specialized banking services that preceded it. With the transformation of many small and fragmented specialized banks into less numerous but bigger institutions able to provide a wider set of services, the government intended to achieve economies of scale and an improvement of the credit system; from the government's perspective this initiative was intended to modernize the financial and banking system (Tello 2006).

The policy was successful if one considers that by 1978, 90% of the banks passives were deposited in multiple banking institutions, while the specialized ones only count with the rest 10%. However, during the progression towards universal banking –happened throughout the presidential period of Lopez Portillo- the new banks led a course of integration with other industrial and services enterprises, in a process of industrial-financial conglomerates' building (Tello 2006) that eventually would proved pervasive for the Mexican economy. Tello estimates that by the end of the seventies, probably all the important entrepreneurial groups had strong linkages with banking institutions, whether as investors or as owners[4].

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[4] This group structure in which there are a few but powerful industrial-financial conglomerates –and their ability to severely influence important flows of capital and money to the country- is seen by Garrido as one of the institutional factors contributing to the recurrent banking and economic crisis that Mexico underwent between 1976 and 1998 Garrido, C. (2003). Mexico's Financial System and Economic Development: Current Crisis and Future Prospects. Confronting Development Assessing Mexico's Economic and Social Policy Challenges. K. J. M. a. E. Zepeda. California, Stanford University Press.

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Therefore regarding our analysis, the key element of the reforms that promoted universal banking refers to the fact that "it allowed the banks to form ownership ties with industrial firms", concentrating power in few financiers and strengthening the power of the banking sector vis-à-vis other industries (Auerbach 2001:57,58). In addition, the emergence of financial-industrial conglomerates was combined with the fact that, given their access to foreign markets, the –usually family owned- financial holdings that controlled the conglomerates find more profitable the short-term investment in speculative transactions than the long-term investment required for industrial development, which also contributed to the subordination of industrial to financial activities.

In conclusion, the process of universal banking originated in the 1970s eventually led to a marriage between financial and industrial capital in which the interests of the latter exerted dominance. In this sense Auerbach argues that, "the answer to the proposed question about why industrialists act more like bankers in Mexico is straight forward: Mexican industrialists are bankers to a great extent" (Auerbach 2001:62).

4.6 From the bankers' alliance to the conflict with the bankers

This section will outline the emergence and consolidation of the bankers as a powerful group, happened between the 1940s and the 1970s. Then it will review how there was an increasing conflict among the bankers –an exclusive and non-encompassing organization for collective action- and the state -embodied around the president-; this conflict was to a large extent based on the amount of power the bankers had acquired, which attempted against the power of the presidency as the hegemonic faction within the governing coalition.

As already mentioned, the political and economic stability provided by the revolutionary regime set the basis for the development and strengthening of different groups and new distributional coalitions. In the case of the bankers, there was a somehow natural expansion product of the modernization and industrialization of the state. Furthermore, since the 1940s and until the decade of the 70s, there was a clear alliance between the PRI and the banking sector.

According to Maxfield (1990b), for more than three decades –from the forties to the sixties- there was a clear alliance between bankers and government –what she calls "the bankers alliance". Although this paper does not share Maxfield's claim in the sense that

Mexico's decision making in the mentioned period can be better understood mainly through the analysis of this alliance, her work provides useful insights to the history of the bankers as an important distributional coalition.

During this period there was a fluid and harmonious relationship between the Ministry of Finance, the Central Bank and the most important private banks; the bankers were the main speakers representing the interests of the private sector. There was of course a *quid pro quo*: the government would guarantee macroeconomic stability and a protected financial sector, and the bankers would allocate resources in priority areas and finance public deficits; the latter was done to a large extent through reserves requirements and deposits in the Central Bank. In addition, bankers –as the rest of the private sector- would abstain from participating in politics (Maxfield 1990b). This period –from the 1940s to the 1960s- was known as "stabilizing development": a time in which Mexico experience high growth rates, low inflation and exchange rate stability.

However, as it has been mentioned elsewhere, the relation between bankers and state -embodied in the presidency- it's a dynamic one (the same accounts for the role of the bankers as a group for collective action looking to increase their members' benefits). In this sense, Auerbachs (2001) remind us that structural changes in the financial sector implied shifts in the balance of power.

Since the early 70s, the private sector began to be disenchanted with Echeverria's government policies (1970-76). In that context, the business class decided to create their first formal organization for collective action: the Business Coordinating Council (Consejo Coordinador Empresarial, CCE) (Luna and Tirado 1993). This organization had the objective of defend and promote policies that would guarantee business' interests. It is worth mentioning that financial capital was disproportionately over-represented within the organization: while the financial business accounted for only 0.7% of the membership, they had 3/7 of the voting power and seats within the council. Distancing itself from the tradition of non-intervention in politics, the CCE began to criticize government policies and try to intervene on the decision making process event against the president's will. During the Lopez Portillo's presidency (1976-1982), the critic turned into open confrontation between business and government (Luna and Tirado 1993).

By 1970s the bankers had acquired enough power to make the presidency (the hegemonic faction of the governing block) aware of the need to promote alternative financial markets and agents that could counterweight its dependence on commercial banks. Supported by the government, the stockbrokers founded in 1980 the Asociacion Mexicana de Casas de Bolsa AMCB (Stockbrokers Association), which was suppose to counterbalance the power and influence of the Asociación de Bancos de México ABM (Banks Association), and widen the financial sources available to the regime (Minushkin 2002).

In this sense, the *bolseros* (stockbrokers) and the *banqueros* (bankers) began to develop as two different interest groups or capitalist factions and started to participate in the policymaking process as differentiated players. The government supported the development of *bolseros* –and stock and security markets- as a way to counterbalance the rising power of *banqueros*, which had been well established within Mexico's governing elite during the Porfiriato (1880-1910), and again with the Revolutionary regime since the 1940s (Minushkin 2002).

Accordingly, the government's policy decision to support the securities and stock market generated a relatively early development of Mexico's financial system, as well as new players and markets within the financial industry since the late 70s and early 80s (Minushkin 2002). It could be argued that the government's decision promoted the material basis and eventually led to the development of a new capitalist faction whose power was leveraged on the following: the benefit of the presidential favor, access to foreign capital markets, the mobility of its assets, and eventually, the amount of transactions they (the stockbrokers) intermediated and the high profits that came with it.

In spite of the aforementioned, when in the early 1980s the economic imbalances became too obvious, the faction of the bourgeoisie that owned the banks –which had been previously beneficiary of the regime and the institutional arrangements, including the presidential favor-, which had use bank profits in acquisitions rather than investment, began to accelerate capital flight. In this way, falling oil prices, increasing burden of foreign debt altogether with capital flight provoked financial strangulation and provided the basis for banks' nationalization (Garrido 2003).

In 1982, in a conflict that could be conceptualized as a *tour de force* among two different organizations for collective action (the PRI commanded by the president and the bank's association commanded by their owners), López Portillo –using the presidential imperial power mentioned in previous sections- decided to nationalize the banks.

In terms of policy design, the nationalization then had two analytically different sets of goals: a political and an economical one. Regarding the former, it could be said that the president taught a lesson to the bankers and made them pay their disloyal behavior; it was a way of weakening an industry that had become to powerful and that was endangering the equilibriums that PRI presidents had to guarantee. It also helped to silence criticism from leftist and popular sectors that claimed for State control over the credit system (Hamilton 1984). And ultimately, as already mentioned, it looked to reinforce state sovereignty. On the economic discourse of the equation, the nationalization was supposed to allow a better allocation of credit and more decided support towards productive activity; the banks nationalization reflected the last breath or vain effort of Mexico's political elite in carrying out a development model away from what would be called Neoliberalism.

From a somehow similar perspective, the banks' nationalization in Mexico also illustrates the tensions generated by the ascendancy of global financial capital. As in the case of France's and Peru's banks nationalization, Mexican "government elites perceived the internationalization of financial markets and the power it accorded domestic financiers to be eroding national control over monetary affairs and industrial capacity. Nationalization was rationalized as a way to regain national economic sovereignty" (Maxfield 1992).

According to the aforementioned, then, it is important to briefly outline the changes in the international economic structure that also underpinned the increasing power that financiers acting as an organization for collective action reached. This is discussed in the next section of the chapter.

4.7 Changes in the international economy underpinning the financiers' collective action strength

As has been mentioned, the power of a group acting as an organization for collective action is related to their size and nature; however, it is also contextual and relational. Changing circumstances have an effect on the bargaining power of different groups, and the bankers or financiers are not at exception to this.

It is precise to mention that in parallel to Mexico, since the WWII and until the late 70s, many regions of the world also witnessed the strengthening of the state's role in their economies, which "was to a large extent based on the application of Keynesian policies to the depression-ridden economics of the 1930s" (Hamilton 1975:98).

The depression of the interwar period and the horror of World War II led the international community, specially the big powers, to look for arrangements that could avoid the repetition of both, economic crisis and the nationalistic totalitarian governments that emerged from it after the 1930s. On the domestic front, the solution was the welfare state, or, as Ruggie (1982) calls it, "embedded liberalism". On the international, it was to manage currencies and coordinate international payment imbalances (Martinez 2009:185-188).

The Bretton Woods architects "sought to prevent global financial markets from reassuming the dominant role they had held in the global political economy in the decades" previous to the Great Depression. Therefore, the Breton Woods Agreement "endorsed the use of capital controls" (Helleiner 1995:314). The theoretical underpinnings were provided to a large extent by the Mundell-Fleming unholy trinity[5].

In this sense, the international monetary system that emerged after WWII comprehended a mix of fix and flexible currencies: the US dollar was fixed to gold (US$35 for an once of gold) and then other countries had flexible currencies convertible to dollar. The International Monetary Fund (addressing short-term and balance of payments problems) and the International Bank for Reconstruction and Development (long-term development finance) were supposed to provide stability to the monetary system and help to post-war reconstruction. Unfortunately, the system experienced shortcomings relating to liquidity and inflation problems, due mostly to the constraints imposed by a dollar fixed to gold (Eichengreen 2000).

The abandonment of the Breton Woods system in 1973 signaled the beginning of a new era of floating currencies and market supremacy. In words of Mundell, the "last third of the twentieth century started off with the destruction of the international monetary system and the vacuum sent officials and academics into a search for structure."

5 The Mundell-Flemming theorem proposes that it is not feasible to have an open capital account, floating exchange rates and an autonomous monetary policy. Then for example, an autonomous monetary policy requires keeping a closed capital account or a fixed exchange rate.

(Mundell 2000) Although the searching and establishment of a new structure was not a process absent of contradictions neither a mechanical one, evidence suggests that since then, the world economy witnessed increasing financial integration and the empowerment of mobile capital' owners vis-à-vis other actors.

In this sense, a distinctive feature of the post-Breton Woods international monetary system was international financial integration, which increased "capital's power to constrain government economic policy by threatening to exit… (Increasing) the structural power of capital, particularly of those with most liquid assets" (Maxfield 1992). In terms of the international political economy, finance stopped being the servant which had been during Breton Woods (Cerny 1993) and eventually became the master.

4.8 Conclusions of the chapter

The correlation of forces emerging from the Mexican revolution favoured political-military power over the power of capital and labour, which allowed for an autonomous state in which the hegemony was exerted by a bureaucratic elite. Under this system classes receive their recognition expressly from the state, which reasserted its supremacy through the monopolist ownership of natural resources and the prohibition of private investment in strategic sectors as the energetic and oil industry, limiting the power of capital and private property.

This Weberian state had as its main characteristics a representative democracy, a presidential dictatorship, and corporatism. It was a highly centralized structure with the president of the Republic at the peak of the hierarchy. An encompasisng social pact representative of different –and at times divergent- societal sectors was embodied and structured around the revolutionary party. As an encompasisng organization, the revolutionary party focused its energies in increasing the size of the social cake –the economic ouptut- rather in only getting a bigger share of it for its members. The latter was reflected in the foundations of economic development after the Revolution.

As theory predicts, the several decades of stability provided by the revolutionary regime, allowed the emergenge and configuration of new distributional coalitions -groups of collective action directed to increase benefits or collective goods for its members. Such was the case of the bankers, whose strenght and organization were also beneffited by both, the protected oligopolies allowed and promoted by the revolutionary regime, and the changes in the international monetary system as the end of Bretton Woods and the increasing financial integration. Harmony between bankers and the state began to come to and end in the 1970s, moment in which the former had already developed considerable power.

Chapter 5

Case Study of distributional coalitions in contemporary Mexico

5.1 Introduction

This chapter will apply in more detailed the method of process-tracing to what it is argued to be the peak of success of the banking sector as a distributional coalition: the banks privatization and their bail out. This chapter does not argue against or in favor of the aforementioned decisions per se, rather, it analyzes the way the bankers' distributional coalition was unfairly benefitted given the specificities with which both procedures –privatization and bail out- were carried out.

This chapter applies the process-tracing method to the banks privatization under Salinas' government and to the bail out during Zedillo's presidency. It's important to remember that process-tracing refers to "Investigate and explain the *decision process* by which various initial conditions are translated into outcomes (…) The process-tracing approach attempts to uncover what stimuli the actors attend to". (George & McKeown, 1985:35).

5.2 The general context: the Salinas' presidency neoliberal project

Regarding the initial conditions, it is important to bear in mind the general context in which the banks were privatized. In the case of Mexico, this refers to the Salinas *sexenio* (1988-1994) and most specifically to the project that he as the head of the most powerful political institution in Mexico –the presidency- was trying to carry out.

As his predecessor and successors, Salinas believed that free-trade policies and international integration were the only solution to Mexico's economic puzzle (Centeno and Maxfield 1992). Holder of the knowledge, network and ideology of a PhD in Political Economy and Government from Harvard, Salinas tried to implement a major shift within Mexico's economy during his presidency: the shift implied moving from an internally oriented system of production towards an outward oriented, redirecting and redefining the productive apparatus towards an export led growth model. Furthermore, the project of economic modernization or neoliberal reform required, at least theoretically, surpassing and dismantling previous corporative state structures, which failed to meet the requirements of flexibility and efficiency imposed by the new market hegemony.

In this sense, for example, the growth of the maquiladora (in-bond) export industry helped the government to undercut corporatism since Salinas' presidency, both because weak company unions characterized these plants, and because they were located geographically and politically far from Mexico City, where national corporatism bargaining takes place (Samstad 2002). Furthermore, the transformation of the interests' intermediation structures and procedures according to the new paradigm of market supremacy was not limited to the factors of production; it permeate to other areas of public action, as was the case of social policy (Fox 1994).

However, more than democratizing the political system, the presidency wanted to reshape the forms and mechanisms of Mexican authoritarianism, according to what the model of neoliberal reform required. Organized labor, peasants, small commerce (which employs most of the labor force) and the small inward looking enterprises were no longer clear allies. Instead, the new governing coalition was supported by big export-oriented companies and mostly by the financial groups that owed them. Although the neoliberal paradigm was clearly informing the general direction of policy making, once and again the implementation of policies designed under neoliberal glasses was adjusted and modified according to the interests of certain stakeholders. However, Teichman (1997) argues that Salinas and his ruling coalition were "tenacious in adapting clientelistic and corporatist methods of political control to its neoliberal economic model."

Important as well was the fact that this conjuncture turned out to be very fortunate for the owners of financial capital. As the theory from section 3.1 mentions, the state as the institutional landscape in which political actors make decisions is not neutral. Rather it has a strategic dimension in the sense that it tends to benefit some certain players and outcomes above others (Jessop 1990) In this case, there was a clear convergence between the project embraced by the president and the aims of those that belonged to the financial industry.

In other words, the State that Salinas envisioned and promoted tended to benefit financial groups above other societal sectors: the banks privatization expressed the neoliberal paradigm which both, situated development as a task to be carried by the sum of individual wills, and pave the way for the expansion of capital and private sphere over public domains, but also signaled an alliance between financial domestic capitalists and the presidency (Schamis 1999).

According to the premise of dismantling the state's influence in the economy, there was a retrenchment of the State in terms of the expansion of private over public sphere (as for example with the privatization of public assets, the commoditization of *ejidos*, or the tendency to abrogate previous restrictions to capital). However a paradox appeared to exist: the government was an active promoter of its development model, exerting sovereignty and constituting itself as a leading actor of the economic reform process.

In conclusion, Salinas had the aim of transforming the Mexican economy from inward to outward oriented. He carried out the privatization of public enterprises and promoted the dislocation of corporatist structures that could oppose him. Salinas' project implied the re-configuration of the alliances supporting the presidency; therefore the implementation of reforms was not absent of political considerations. Given the neoliberal character of the reforms the State was experiencing, owners of mobile assets -financial capitalists- founded themselves in a strategic and preeminent position, which situated them as natural allies of the regime.

5.3 Financial liberalization as the benchmark for banks' privatization

Under the new neoliberal paradigm, the banks should not longer be induced or forced to contribute -under the lead of a public entity, the State-, towards development. Rather, from then on, the contribution of banks towards development would come from a trickle down effect. The logic was the following: let the banks (or any other economic actor) to act freely in their pursuit of profit, and the more profits the banks make the wealthier the economy will be, and therefore society will be better off too.

It was the international context and the discourse of a required financial liberalization that provided the theoretical underpinnings for the upcoming banking reforms. Although the financial sector under Salinas was far from being liberalized (his government argued that it could destabilize the economy), they set the banks privatization as the first step towards an eventual financial liberalization of the sector.

Theory tells us that financial liberalization is a process that seeks to improve efficiency of capital allocation in the financial system, and implies freeing previous regulations on financial capital. This is expected to increase the funds available to firms and therefore contribute to economic growth. Ideally, it includes measures as the release of interest rates ceilings, the introduction of domestic and foreign competition in the financial markets, and the opening of the capital account (Allegret, Courbis et al. 2003).

Based on the assumption that state participation reduces market or efficient allocation of capital in the financial sector, liberalization proposes the retreatment of the state from the financial sector in order to allow market signals -the invisible hand- to emerge. The aforementioned implies not only the "decline of directed credit and the removal of requirements for special credit allocations to priority sectors", but also the granting of autonomy to the central bank –which in Mexico was formalized in 1994-and the shift towards self-regulation by the financial agents (Ghosh 2005:2,3), which became preeminent as soon as the banks were privatized. Additionally, financial liberalization also requires to blur previous distinctions between banking and non-banking financial institutions, allowing banks, insurance companies and brokerage houses to compete in each other sectors (O'Brien and Williams 2004; Ghosh 2005).

With regard to the capital account opening, financial liberalization includes allowing inward and outward direct and portfolio investment (FPI) as well as the release of entry prohibitions to foreign intermediaries. On its full version, the aforementioned means to allow domestic residents buy and sell shares of stock or bonds issued in local or international markets; allow foreign residents to buy and sell securities on local markets; permit "market based individual or corporate borrowing from domestic and international institutions" and, allowed foreign firms to purchase and establish domestic intermediaries (Maxfield 2000É96). On the other hand, financial liberalization can be linked to the liberal view expressed by the Washington Consensus, which considers that currencies' exchange and credit provisions should be determined by private firms interacting in the market place both in the domestic and the global financial system (O'Brien and Williams 2004:228).

To conclude, we can assert that financial liberalization benefit liquid assets owners more than other societal groups. This is so given that financial deregulation expands the chances for liquid assets owners to access financial adaptation instruments (capital flight, dollarization, etc.) in order to protect themselves from inflation and diminish their taxable base. The latter can increase inflation and welfare losses for those groups that do not have access to financial adaptation, who will bear the burden of adjustment. In addition, when in the context of financial liberalization banks are privatized, this can lead to a "concentration of assets and interlocking ownership that allow financial institutions to engage in unhealthy lending practices" (Schamis 1999:243,244), as it was the case of Mexico.

5.4 The new relation between bankers and the presidency

According to the tenants of what Williamson called the Washington Consensus (Williamson 1990), Salinas privatized the banks, however, he did not liberalized the sector, not allowing national or foreign competence. During this period, political allies of the presidential regime –members of the governing coalition- controlled the banks. The owners of industrial capital and former stockbrokers -from "big entrepreneurs" to oligarchs- were offered the banks at a very high price in exchange of economic protection and political favor; it was a high investment but with a higher future return, thing that under the logic of profit could not be rejected by them.

The banks served the regime on its higher need or purpose of reacquiring legitimacy[6]. Through different financial maneuvers –from the exchange rate control and overvaluation of the currency to interest rates and allocation of credit-, the governing coalition was able not only to enrich itself but also to deliver wealth among other constituencies, specifically those poor areas which had voted for the opposition in the 1988 presidential election that took Salinas to power (Kessler 1998).

During Salinas' presidency and the privatization that characterized it, most of the government's sale operations -including the US $12 billion banks' sale - were carried out through the stock market, which was also a reflect of the government's interest in developing this market and supporting its political allies, the *bolseros*. Even more, many of the state-owned banks were sold to stockbrokers, some of which previously had been bank owners and after the banks' nationalization in 1982 found refugee in the securities (Minushkin 2002).

Nonetheless, if asked why did the banks' privatization in Mexico turned out to be a major disaster (most of the banks went bankrupt few years later, and the initial income of 12 billion of its sale transformed into a fiscal burden of 98 billion), economists usually would argue that the design was mishandled, that the legal framework was not adequate, that net-worth and capital adequacy standards were not met; and probably they will be right.

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[6] The election that took Salinas to the presidency was the most competed from the last 50 years, and the first one in which the regime saw its electoral hegemony treated (almost everybody agrees that there was some fraud, people differ on the degree on it). In any case, Salinas faced the urgent need of recovering regime legitimacy (expressed as electoral support).

However, one should wonder why it was so? Why did an administration referred by The Economist as “probably the most economically literate group that has ever governed any nation anywhere" (Melvin 1992) engineered a banks’ privatization so deleterious for social and economic development? The answer, this paper argues, is that the banks privatization had among its main objectives to provide economic benefits for Salinas’ political coalition, disregarding the common good or the sector economic functions and performance.

5.5 The continuum: from banks privatization to banks’ bail out

The following section reviews, as part of a continuum, the influence of private firms in the banks’ privatization auction process; the collusion between authorities and bankers, the banks’ bankruptcy and finally the banks’ bail out. In order to so, it follows the process-tracing method, trying to identify which were the arrangements that lead to certain outcomes (the initial conditions or context has been outlined in the previous sections of the chapter).

Regarding the banks’ privatization, what happened fits our theory of collective action prediction, in the sense that it can be expected that banks or lenders will face less difficulties in reaching agreement to protect their interests than will do the borrowers. This is due to the fact that the former tends to be integrated by a small number of people that has a clear gain or benefit from influencing the system. On the opposite, borrowers and deposit owners will face what literature calls diffuse interests and therefore will find it more problematic to organize their collective action. Rosenbluth and Schaap phrase it in the following terms: “All else being equal, banks have a collective action advantage over the average depositor, and one should expect regulation to mirror that by transferring wealth from depositors to banks” (Rosenbluth and Schaap 2003).

Finally, before starting the next subsection, it is precise to remind what the notion of state capture refers: a situation in which private firms participate or define “the formation of the basic rules of the game (i.e. including laws, rules, decrees and regulations) through *illicit* and non-transparent private payments to public officials.” In this sense, it is precise to overview the way the privatization process happened.

5.5.1 Influence of the firms in the auction process

This section traces the way the future banks' owners intervened in the privatization procedures as well as the governmental response to their demands, pointing out to the effects that the resulting outputs had in the banking sector. In doing so, it also considers what out theory of collective action (section 3.3) would predict on the matter.

As a cautionary note it must be said that as many of the agreements between firms (in this case mostly brokerage houses property of Salinas's allies) were either illegal or at least non-transparent, then there is lack of official documentation on the issue. In spite of the aforementioned, it is possible to state that the government's objective was to raise the higher quantity of financial resources out of the privatization process; in order to achieve that goal, Salinas' administration overlooked its own legal statements (e.g. the rules for the disincorporation of the credit and financial institutions) and promised to the firms interested in buying the banks that they would be protected from competence and would be able to extract more than competitive returns from Mexican consumers.

It also has to be noticed that when the banks were privatized, the government did not require previous experience on the banking activity to the potential buyers. In other words, expertise to handle such a complex business was not required by the administration (Kantor 2003), contravening its own established rules (see for example the decree through which the disincorporation unit –responsible for sailing the banks- was created, which stated that the possible buyers should have proved ability to manage the business).

Additionally, as the theory mentioned in section 3.3 predicts, the small and exclusive group of future bankers did not find it difficult to organize and influence the government (providing themselves with a collective good, in this case under the form of an ad-hoc auction process). According to the governments' original auction rules, there was supposed to be a 30% payment three days after the auction winner, followed by the other 70% in the next 30 days. However, the potential buyers –all supporters of the regime- convinced Salinas and his team to modify the rules, expanding the timing and allow them to raise money in foreign markets; Salinas agreed on this request (Haber 2004). Here, therefore, we find that the private firms were actually influencing the rules of the game; the way things would be done. Under the private firms accepted plan, the first payment was reduced to 20%, a second payment of 20% was to be paid 30 days later, and the remaining 60% was to be paid four months after that(Haber 2004).

The bankers used the five-month period amid the sale and the final payment to obtain funds to purchase the banks from outside investors. These funds came from a variety of sources—small Mexican investors, commercial paper, foreign banks, other Mexican banks, and in some cases, the same bank that had been purchased. That is, "some shareholders were able to finance or refinance their share purchases with a loan from the same bank they were purchasing, with the collateral for the loan being the shares that were being purchased. In one particularly well documented case, a group of purchasers actually financed 75 percent of the cost of acquiring a bank in this manner." (Haber 2004:13).

In spite of the aforementioned, and as aggravate, the Salinas' administration carried out legal reforms to criminal law after which financial crimes were no longer classified as serious (Rosales, Birch et al. 2002:33), which meant that financial delinquents were able to pay a fine and face their process in liberty, disregarding the magnitude of their frauds and the harm imposed on economic development and society's well being. From the theory mentioned in section 3.3, the latter could be seen as the granting of an additional collective good to all those financiers (and eventual fraudsters) that were getting involved in the banking industry.

In short, the new bankers were not risking their capital, but rather, they were risking borrowed money. This situation, combined with universal deposit insurance, led to moral hazard situations in which the bankers were engaging in dubious lending practices. In this sense, again, its hard to imagine that Salinas and his "economically literate" team were not conscious about what Bernanke and Gertler define as a general rule, that is, "the less of his own wealth a borrower can contribute to the funding of his investment "project," the more his interests will diverge from those of the people who have lent to him." (Bernanke and Gertler 1990:88)

In conclusion, the buyers of the banks did have an influence in modifying the rules through which the banks would be acquire. The small number of buyers and the consequent advantages provided by this in terms of collective action facilitated the aforesaid influence in the auction process. The outputs emerging from this original outputs proved pervasive for the future development of the banking system.

5.5.2 Collusion by omission

This section analyzes the evidence regarding another dimension of state capture as define by section 3.2, in this case, collusion regarding government' regulation and the bankers' behavior. In doing so, it highlights the aspects that on one hand were pervasive for the banking system and on the other, delivered big amounts of wealth to the banks' owners.

Notwithstanding the fact that the brokers turned into bankers were not investing their own capital, the Salinas administration established since 1990 universal deposit insurance (the so called FOBAPROA), which raises moral hazard problems between the banks (owners) and the insurer agency (Boyd, Chang et al. 1998), therefore requiring stricter prudential regulation from the government (Rosenbluth and Schaap 2003), which the economically enlighten Mexican administration did not put in place.

In accordance with the aforementioned, evidence from later in the 1990s (the period 1995-98, when the government was intervening insolvent banks) indicates that "the bankers had engaged in widespread insider lending, and that the loans they made to themselves had lower interest rates, higher rates of default, and lower rates of collateral recovery than unrelated arm's- length loans (La Porta, Lopez-de-Silanes, and Zamarripa 2003:18). Again, is hard to believe that Salinas (PhD in Political Economy and Government from Harvard), his Treasure minister Pedro Aspe (PhD in Economics from MIT) and the Treasure under secretary Guillermo Ortiz (PhD in Economics from Stanford) were so unaware of the shortcomings of the privatization they carried out. Rather, evidence suggests that an important degree of collusion between this techno managerial elite and the private firms existed.

As will be show further, the latter group was also expected to contribute to Salinas' political proselytism, financing electoral campaigns and mobilizing resources for the members of the governing coalition. The aforementioned happened without regard of the common good. The problem of this quid pro quo was that it laid down the foundations for a banking system that while very beneficial for the small minority that owned it, would impose serious social end economic costs to the nation.

In conclusion, Salinas and private firms (mostly brokerage houses) colluded and reach an agreement that on one hand would provide much needed revenues to the government, and on the other would guarantee an oligopolistic business to a select group of presidential political allies; in this equation, economic and social development was secondary.

5.5.3 From private to bankrupt banks

Only four years later after their privatization, the banks sold by Salinas to his political allies (mostly owners of mobile assets and brokerage houses) turned insolvent and the whole banking system had to be rescued by the government, which assumed the banks' non-performing loans (Kantor 2003). Although some scholars argue that the banking system went bankrupt as a consequence of the 1994 economic crisis, this paper has showed that the private banking system was poisoned since its very beginning.

Truth is that the economic crisis and the peso devaluation from 1994 increased pressure on the banks' non-performing loans. However, the majority of the banks went bankrupt because the mismanagement (and corruption) of their owners. As already mentioned, banks' owners were political allies of the president, and, as predicted by our theory, they got the ownership of the banking oligopoly in exchange of political support, both financial and material.

That was the case of the businessmen that Salinas presented as exemplary during his term in office: Carlos Cabal Peniche, whom, evidence suggests, not only made serious financial frauds lending money to himself without guarantees or collaterals and leading his bank to bankruptcy, but also contributed with important sums of money to different electoral campaigns of PRI politicians, as the one of Salinas' ally in the province of Tabasco, Roberto Madrazo (Curzio 2000:176), whom has claimed that also former president Ernesto Zedillo (Salinas' successor) received "donations" from Cabal Peniche (Cruz 1999).

Furthermore, there is probe that at least since 1993 the authorities (specifically Guillermo Ortiz, Treasure undersecretary) had information regarding the financial mismanagement of the banks (Roberto González Amador, Cuellar et al. 2002); however, they decided not to act. Maybe, the 1994 presidential election was too close like to publicize that the president's "exemplary businessmen" was in reality a fraudster.

In conclusion, the agreements between the government and the financiers provided benefits for both in the short run but eventually lead to the bankruptcy of the banks. The financiers were allowed by the government to manage the banks in such corrupted ways that eventually lead many banks to bankruptcy. This proved pervasive for Mexico's economy and social well-being.

5.5.5 The banks' bail out: drama to avoid a tragedy or the financial distributional coalition "exemplary" accomplishment?

The Mexican peso crisis in 1994 aggravated the banks bankruptcies situation, putting the system of payments in risk of breakdown; the banks were bail out by Salinas' successor. With that regard, in a recent conference, former president (1994-2000) Ernesto Zedillo argued that the banks' bail out his government instrumented in Mexico was a necessary drama in order to avoid a tragedy. No question that can be a way of seeing it: given the systemic risk of the payment system collapse –and a major economic depression-, the government had to intervene and minimize the risks. However, a more detailed look at the process suggests that the bail out was more than "avoiding a tragedy"; it was also a master lesson on how collusion and state capture can lead to a disproportionate increase in the amount of wealth (rents) that an small minority –the financial distributional coalition- extracts from society, disregarding social and economic costs, let alone ethics and morality.

As it has been mentioned, Salinas established universal deposit insurance, measure that remained unaltered during the bail out carried out by Zedillo. Additionally, Salinas did not look to establish a competitive banking sector; therefore, when he sold the banks to private firms, he allowed an oligopoly market structure to remain. In this sense, when the crisis began to unfold, many bankers found themselves being "too big to fail" and protected by universal deposit insurance, which allowed them to anticipate the government would bail them out. The latter was an implicit invitation to make "large loans to themselves –and then default on the loans" (Haber, Klein et al. 2008:115). In other words, once the economic crisis showed up, both the regulation put in place and the absent one, guaranteed to the bankers a round business: the legal regulations established by the techno managerial elite (so closely allied to the financial industry) provided the framework to carry out huge financial frauds (which, casually and thanks to Salinas, were no longer consider as "serious" offenses under the criminal law) at the expense of taxpayers.

Furthermore, deposit's insurance (known as FOBAPROA) operation rules were modified in a very suspicious way. In 1995 in the early aftermath of the crisis, not all non-performing loans were entitled to be rescued by the FOBAPROA. However, the government later change his decision in a way that is difficult to understand without some degree of state captured (i.e. private firms influencing the rules governing the banking rescue).

Originally, loans held by bankrupted companies; loans made in conjunction with government-operated development banks; past-due loans; loans denominated in inflation-indexed investment units (UDIs) and loans to associated parties were not subject to be rescued. However, as the banks' situation got worst, the public servants running the rescue plan modified the rules and consequently, "banks were able to transfer to FOBRAPROA a large number of loans that were highly unlikely ever to be repaid, as well as loans made to the banks' own directors or to the directors' families or firms" (Haber, Klein et al. 2008:116). The FOBAPROA was transformed to an open-ended fund to which many bankers were throwing fraudulent non-performing loans between 1995 and 1999.

Under the bail out scheme design by the Zedillo and his techno managerial elite –the Portfolio Purchase Program-, FOBAPROA assumed banks nonperforming loans in exchange for promissory notes with a 10-year maturity (i.e. 2005); the government would pay -with public money- interests on these promissory notes to the banks (Garrido 2003:113), while making the banks responsible for "collecting the principal and interests due on the loans" that were being traded for FOBAPROA's promissory notes. However, banks did not do so: not only those were loans with low probability to be repaid, but also Zedillo's administration had just granted them low risk government bonds in exchange of the aforementioned non-performing loans (Haber, Klein et al. 2008:115). The aforesaid generate a very convenient situation for the bankers but no incentive to seek the repayment of the looting they were carrying out; thanks to the government regulations –or the financial distributional coalition success-, it was the taxpayers and not the corrupted bankers that would repay the bad loans and the losses product of corrupted practices.

Not only the irregularities but also the amount of the bail increase during the second half of the 1990s. By 1996, the banks bail out amounted to US 40 billion in 1996, 60 billion in 1998 and 98 billion in 1999 (equivalent to almost 22% of that years' GDP) (Garrido

2003:116). To provide an idea of what does a bail out like that means, it is worth mentioning that according to IMF (IMF 2009) estimates, the banks' bail out by the US government –in the context of the worst economic crisis since the Great Depression- will amount, for the years 2008-2010, 12.7% of their GDP (proportionally less than what Mexico is still paying for rescuing its banks, which is 13% of the GDP (Banxico 2007)).

A detailed studio about related lending in Mexico (Porta, Lopez-de-Silanes et al. 2003) provides support to what has been mentioned in above paragraphs in terms of collusion, corruption, bad practices and a degree of state capture during the bail out process. As has already been mentioned, the FOBAPROA became and open ended process (at least from 1995 to 2000) through which banks keep recovering money from non-performing loans. Well, the aforementioned research published by the MIT press, presents the following:

> "We first examine the identity of each bank's top 300 borrowers by total loan size. For each bank, we then collect information on the borrowing terms of a random sample of 90 loans from the top 300 loans outstanding at the end of 1995 and track their performance through December 1999. We find that 20 percent of loans outstanding at the end of 1995 were to related parties and that banks sharply increase the level of related lending when they are in financial distress. Related parties borrow at lower rates and are less likely to post collateral. However, after controlling for borrower and loan characteristics, related borrowers are 33-35 percent more likely to default than unrelated ones. We also find that the default rate on loans made related persons and to privately held companies related to the bank is 77.4 percent. The equivalent rate for unrelated parties is 32.1 percent. Moreover, recovery rates are $0.30 per dollar lower for related borrowers than for unrelated ones. Finally, to the extent that we can measure it, related borrowers emerge from the crisis relatively unscathed: bank owners lose control over their banks but not their industrial assets. Overall, the results for Mexico are consistent with the looting view." (Porta, Lopez-de-Silanes et al. 2003)p.233-234

In other words, evidence seems to suggest that during the bail out period of 1995-1999, many bankers incurred in reckless related lending and then transferred the banks' losses, thanks to the government regulations, to the taxpayers. This lead to a phenomena that some members of the opposition lefty party express as "having poor enterprises but with rich businessmen"; also it was the case with the financial industry. After the 1994 peso crisis and during the bail out process, banks were going bankrupted while bankers were getting rich (transferring depositors and investors money to themselves through fraudulent operations and then charging the losses to the taxpayer).

In conclusion, the government's approach to the bail out "did not seek a balanced distribution of losses between debtors and creditors, nor did it promote the rapid recovery of banking and productive activity in the economy"(Garrido 2003:111). In words of Haber, Klein et al., "the banking system bail out involved an implicit transfer of large amounts of money from taxpayers to bank stockholders –including some of the country's wealthiest individuals" (2008:116).

5.6 Conclusion of the chapter

The 1990s was a very convenient decade for the financial distributional coalition in Mexico. Given the neoliberal project of president Salinas, there was a natural alliance between the presidency and the owners of mobile assets. The banks privatization was a reflection of this.

The banks' privatization main objective was not to strength the banking sector and increase its contribution to economic development. Rather it was to provide extra revenues to the financial distributional coalition. As theory predicts, the small group of future bankers were able to influence and modify the rules governing the privatization process and the banks regulations. Although the 1994 economic crisis contributed to the banks' bankruptcies, the system was poisoned since the very beginning.

The banks bail out was full of irregularities and the rules through which operated were modified in a way that benefitted bank owners. The government regulations allowed and incentive the bankers to incur in losses that were later to be charge to taxpayers. Overall, the bail out design did not promote the improvement of the banks' role as leverage for economic development; rather it implied a huge transfer of wealth from taxpayers to the bankers (and their distributional coalition).

Chapter 6

Conclusions

First, distributional coalitions refer to groups for collective action that seek to increase their members' benefits through confining wealth for themselves. In order to so, distributional coalitions engage in state capture, influencing governments and modifying rules in a way that benefit their members, often at the expense of society's well being. While encompassing groups seek to increase the total amount of social output, small or exclusionary groups concentrate on getting a higher share of it.

In Mexico, the revolutionary party functioned as an encompassing and hegemonic distributional coalition between the 1930s and the 1970s, therefore concentrating its efforts on increasing output rather than just getting a bigger share of it. In contrast, the hegemonic distributional coalition in the 1990s, led by financiers, was a non-encompassing organization; integrated by a small number of members, this exclusionary group focused its energies on acquiring a bigger share of social output without contributing to its growth and disregarding the social costs of it.

Second, strong states (e.g. those that own means of production) can keep a higher degree of autonomy than weak states in relation to societal groups. Although this relation is not static, crises and social unrest can increase state autonomy vis-à-vis social and economic classes. However, long periods of stability favor the emergence and strengthening of different societal groups and new distributional coalitions.

After the 1910-1920 Mexican revolution, the balance of power favored military and political power above that of capital and labor, which allowed for a strong autonomous state to emerge. The state autonomy was underpinned by the weakness of social classes but also by the state ownership of natural resources as oil and subsoil minerals. Furthermore, private investment was not allowed in strategic sectors as the energetic one, which also limited the expansion and power of capital. The state was embodied around a centralized bureaucracy with the president at the peak.

Third, long stability periods allow for distributional coalitions to emerge and consolidate. When this happens, small groups have advantages over larger groups given the different cost functions they face; voluntary collective action is more wont to arise when the group has only few members. However, small groups usually opt for increasing their share of social output rather than contribute to increasing it.

In Mexico, the political stability provided by the revolutionary regime allowed for the emergence and consolidation of new distributional coalitions, such was the case of the bankers. Given the small number of members and the exclusionary nature of the coalition, the bankers were keen in organize their collective action and to influence and shape the formation of rules within the state. Financial liberalization in the world economy and at the national level strengthened this financial distributional coalition leaded by the bankers.

Fourth, distributional coalitions engage in state capture in order to get extra amounts of benefits for their members (in the form of subsidies, monetary transfers or protectionist measures, etc.) disregarding the social and economic costs that are implied. In Mexico, during the 1990s, the relationship between members of the financial industry and the government translated into extra amounts of wealth transferred to the bankers at the expense of taxpayers. The regulations governing the banks privatization and later bail out were influenced and shaped by the bankers, but did not seek to contribute to economic and social development; rather, they seemed to seek an exemplary accomplishment by a small and exclusionary distributional coalition.

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