

### Mexico: On corruption

#### ... and the efforts to decrease it

In late July, Mexico's Congress approved a package of laws aimed at reducing corruption. The debate around how to tackle corruption has been (and remains) intense in both the media and the political arena. In this note we take an in-depth look at current levels of corruption in Mexico in comparison with its neighbors, efforts at reform, and the impact of corruption on Mexico's economy. We present our findings in a Q&A format.

#### Global Markets Research

9 August 2016

#### Research analysts

LatAm Research

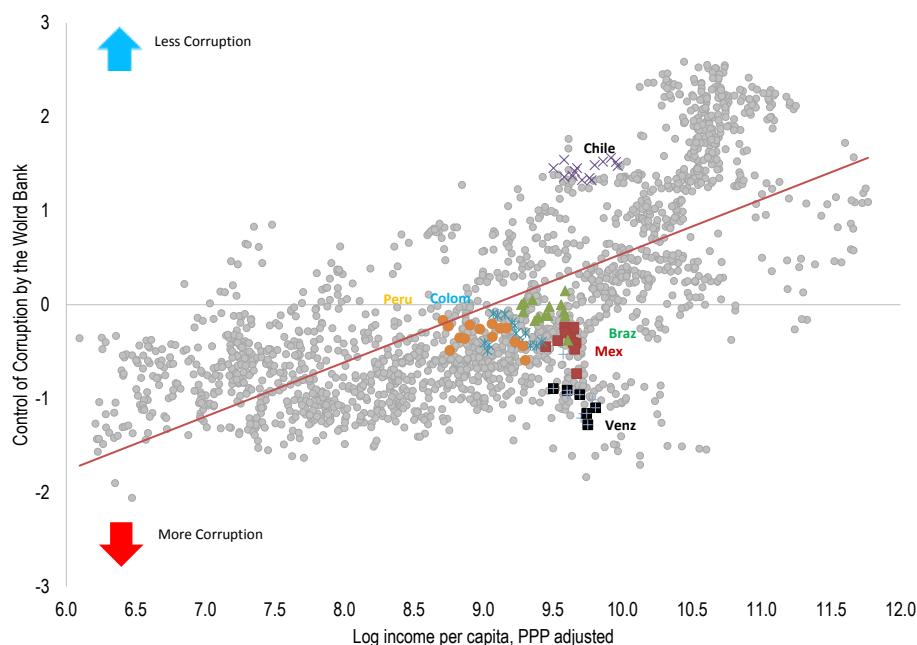
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#### Is corruption perceived as being more prevalent in Mexico than in other countries?

Yes; according to several international indexes measuring perception of corruption, Mexico ranks poorly against the vast majority of countries.

For example, according to the Control of Corruption index compiled by the World Bank, Mexico ranked 160th out of a total of 215 countries in 2014 in terms of the extent to which public power is perceived as being exercised for public gain. Mexico's ranking puts it below all of the major economies in LatAm except for Venezuela. In this note, we compare Mexico with Brazil, Argentina, Colombia, Chile, Peru, and Venezuela in terms of perceptions of corruption.

**Fig. 1: Control of Corruption Index and Income Per Capita, PPP adjusted**



Source: "Transparencia, corrupción y desarrollo económico" IMCO staff: [http://imco.org.mx/politica\\_buen\\_gobierno/41625/](http://imco.org.mx/politica_buen_gobierno/41625/)  
Notes: Control of Corruption Index is between -2.5 and 2.5. A lower number implies perception of corruption is larger.

Other indexes paint a similar picture. The Transparency International Corruption Perceptions Index ranks Mexico at 95 out of a total of 168 countries (but better than

See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Argentina and Venezuela). In the Ethics and Corruption subindex of the World Economic Forum's Global Competitiveness Index, Mexico ranks at 110 among 140 countries (but comes out better than Argentina, Brazil, Colombia, and Venezuela).

It is important to note that these indexes are perception indexes, which means they do not actually track corruption but only survey participants' perceptions of corruption. However, there is empirical evidence suggesting a strong correlation between perception indexes and actual corruption. For example, the Mexican Institute for Competitiveness (IMCO) cites a study ("Corruption, Norms, and Legal Enforcement: Evidence from Diplomatic Parking Tickets" by Fisman and Miguel, 2008, Journal of Political Economy, Vol. 115) that found a link between the perception of corruption index and parking tickets issued to diplomats by the NYPD. Diplomats from countries where the perception of corruption index was higher generally received more tickets.

IMCO also points out that the level of perception of corruption in Mexico is higher even when adjusting for income per capita (see Fig. 1). Countries that are below the regression line have higher corruption perception levels than other countries with similar levels of development. To summarize, the evidence suggests that corruption is a bigger problem in Mexico than in many other countries, including most of countries with similar economic development.

## Has corruption in Mexico gotten worse over the past several years?

There is evidence to suggest that perceptions of corruption have worsened in recent years. According to two indexes of perception of corruption that we track (Control for Corruption Index by the World Bank and Ethics and Corruption—Diversion of Public funds sub-index of the World Economic Forum's Global Competitiveness Index) there has been deterioration since 2012, when the current administration was voted in. However, according to the Transparency International Corruption Perceptions Index, perceptions of corruption have improved marginally since 2012.

## What might explain the pervasive problem of perceived corruption in Mexico?

It is very difficult to determine why perceptions of corruption are so pervasive in Mexico. We believe Mexico does not work with entities that are independent of its government to fight corruption. Also, certain violations such as conflicts of interest have only recently been addressed in Mexico's legal system with the passage of the anti-corruption laws in July. In general, the justice system appears weak, with few convictions for corruption-related offenses and a shortage of highly trained law enforcement personnel.

The level of perceived corruption in Mexico seems similar to that of Colombia. The most significant institutional weakness in Colombia is probably its judicial system. There are several problems related to the judiciary's lack of independence, the control of key institutions by the entities they are supposed to regulate, and too many cases for the investigators to tackle effectively. In addition, anti-corruption institutions such as the comptroller and the general attorney cannot be considered independent because their heads are selected by the president. Another key institution, the prosecutor's office, is highly politicized and suffers from a high degree of political co-optation because its head is elected by the senate<sup>1</sup>.

In contrast, we see Brazil as a good example of a country that is taking steps to decrease levels of perceived corruption. Indeed, the main reason for the greater traction seen recently in Brazil's corruption investigations in comparison with other countries in the region is the independence granted to the Federal Prosecutor's office in Brazil's 1988 Constitution. The office—which is sometimes referred to in Brazil as a "fourth power"—has constitutionally-mandated "operational independence" and "administrative autonomy," which, at least in theory, isolates it from political pressure. Other, less structural and more anecdotal factors, such as a growing internal culture to fight corruption among public officials, have also supported Brazil's recent wave of high-profile corruption investigations.

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<sup>1</sup> Thanks to Mario Castro and Joao Pedro Ribeiro for their contributions to the discussions of anti-corruption institutions in Colombia and Brazil.

## How do the new laws propose to decrease corruption?

Rather than creating one entity to fight corruption, in late July Mexico's Congress passed several laws to regulate a system of entities known as the National Anti-Corruption System ("SNA" in Spanish).

The system comprises an independent anti-corruption prosecutor (to be part of the soon-to-be-created general prosecutor's office), the Federal Superior Auditor (ASF in Spanish), the secretariat of Public Administration, justice courts specializing in matters of corruption, and five representatives of civil society. The SNA's steering committee will be presided over by a representative from the civil society.

The anti-corruption prosecutor will act independently from the General Prosecutor on matters of corruption. Both will be appointed by the president but confirmed by the Senate, and their terms will not overlap with the presidential term. We are hopeful that these two factors will keep them independent from the executive branch.

The ASF is part of Congress and already enjoys credibility. Importantly, it will now be able to audit accounts in 'real time' and not after the fiscal year has ended (as it does now). Also, the ASF will be able to audit states as they receive sizable transfers from the central government (before the laws were approved it was not allowed to audit states). This is important both because gross diversion of public funds has taken place at the state level and also because around 90% of state revenues come from the central government. The secretariat of Public Administration will remain part of the cabinet. The Anti-Corruption System that will operate at a federal level will also be replicated at a state level, according to the recently-approved laws.

The centerpiece of the new system is that the involvement of a strong auditor, an independent anti-corruption prosecutor, and a civil-society led committee to give (non-binding) recommendations on public policies should serve as a source of permanent pressure to decrease the level of corruption.

## Why was there so much debate about "Ley 3de3"?

The "Ley 3de3" proposal was a significant achievement of civil society. It was the first time that a proposal from civil society organizations had to be discussed by Congress following the recent passage of a political/electoral reform allowing for such a referendum mechanism.

The proposal required public employees to disclose three pieces of information: taxes, assets, and possible conflicts of interest. The "Ley 3de3" was only one of the new anti-corruption laws included within the SNA.

The opposition parties in the Senate voted in favor of the law, but the PRI bloc voted against it (it is important to note that if all of the opposition senators had voted in favor of the proposal, it would have passed).

As part of the negotiation, the PRI congressmen threatened to force those who do business with the government (literally millions of people) to be subjected to the same level of transparency. After intense debate and a presidential veto of the first version of the proposal, a revised version of the "Ley 3de3" was passed that eliminated the need to make the statements public.

IMCO, based on research by Djankov et al.<sup>2</sup>, makes the strong argument that making such information public is correlated with a decrease in corruption levels (IMCO "Transparencia, corrupción y desarrollo económico").

[http://imco.org.mx/politica\\_buen\\_gobierno/41625/](http://imco.org.mx/politica_buen_gobierno/41625/)

## Will the new system be effective in decreasing corruption levels?

We spoke with local political analysts who are confident that the changes will effectively decrease corruption levels. However other political consultants are less sanguine about the effectiveness of the changes and believe the entities established as part of the National Anti-Corruption System could be politicized.

<sup>2</sup> Djankov, Simeon, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer (2010), "Disclosure by Politicians", American Economic Journal: Applied Economics, Vol. 2, Num. 2, April 2010, pp179-209.

Our view is that if the new general prosecutor and anti-corruption prosecutors enjoy certain independence and if respected civil society representatives are appointed to the SNA, the changes are likely to reduce corruption.

However, in our view, if there are not tangible consequences for the gross acts of corruption committed by the outgoing governors in the states of Veracruz, Quintana Roo, and Chihuahua, the credibility of the SNA will be null.

## **Will the debate on corruption have an impact on the 2018 presidential election?**

No party is exempt from corruption; however, the PRI is the party in power and governs 15 states out of a total of 32. If the SNA is a failure because it is delayed or because it becomes politicized, we think the PRI could pay the political price in the 2018 presidential election. The new PRI president, Enrique Ochoa, has spoken against the governors (some of whom are members of his own party) who are suspected of deviating public funds. We see this as a sign that the PRI is trying to distance itself from those governors who could hurt the party's chances in the 2018 election.

## **What are the next steps in the approval process?**

The president has to nominate key positions for the anti-corruption system, including the anti-corruption prosecutor, five members of civil society, and the 16 judges for the special courts. All of these appointments will have to be confirmed by the senate. In addition, the PRI-dominated Congress will have to name a new head of the Federal Superior Auditor, whose terms ends soon. Again, while the anti-corruption laws seem sound to us, without credible and respected figures to help implement them, they are unlikely to change the status quo.

## **How important is the topic of fighting corruption for the economy and markets?**

In the context of opening certain sectors of the economy to private participation and competition—i.e., electricity, oil, gasoline, and telecoms (already privatized but now being opened up to competition)—a decrease in corruption is critical for maximizing investment flows. The auction process for oil blocks and electricity contracts to the private sector has been accomplished with a high level of transparency, which is a positive sign.

It seems that markets are not particularly happy with Mexico lately. Markets are worried about Pemex as a fiscal drag on the state, the lack of clarity from the central bank with respect to monetary policy (it is a bad sign that Governor Carstens had to clarify in a WSJ interview that "Banxico is not targeting the MXN"), and about the prospect of Trump winning the US presidential election and what that could mean for Mexico. (We note that the probability of Trump winning the election has decreased recently. According to FiveThirtyEight Polls-only Forecast, Trump's probability of winning has fallen to 17% from a peak of 50% in late July).

While the passage of the anti-corruption laws is a good thing, we think the market may wait until the results are felt to price it appropriately, which could take years. Therefore, the approval of the anti-corruption laws should have a positive impact in the market but only a marginal one—at least until the results are palpable.

# Appendix A-1

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