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*Cronies, rents and import licenses: non-tariff trade controls
throughout Import Substitution Industrialisation (ISI) in Mexico.*

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ABSTRACT: The thesis fills a gap in the literature about Import-substituting Industrialisation (ISI) by analysing non-tariff trade controls – mainly import licenses. The principal focus is on Mexico, a case that has not been analysed in detail. The core questions addressed include: which specific pattern licensing followed; what was the economic rationale behind such pattern; is there evidence that non-tariff controls were ‘captured’ that is, facilitating rent-seeking? In order to answer these questions, the project takes a qualitative and quantitative approach, using primary evidence gathered in archives as well as statistics from secondary sources, which are combined in novel ways. Chapter I reviews the literature on rent-seeking and on Mexican trade and industrial policies. Chapter II provides an overview of the macroeconomic context of ISI in Mexico. Chapter III presents the qualitative evidence, exploring the allocation of import licenses in nine industries, and shows how politically connected firms either obtained licenses (which gave them an advantage via cheaper inputs) or manage to block competing imports (thus earning monopoly rents). Chapter IV provides descriptive statistics of the licensing system, and demonstrates that the policy lacked internal consistency - the overwhelming majority of products were protected for far longer than officially specified, and that illegal source of rents from trade –smuggling and “free perimeters”- were significant. The main findings, which shed light on larger debates about ISI are that excessive protectionism was neither effective nor sustainable and that cronyism characterised the post-Second World War process of industrialisation in Mexico.

Table of contents

Introduction.....	6
Chapter One – LITERATURE REVIEW.....	17
Chapter Two – THE MACROECONOMIC CONTEXT OF THE IMPORT LICENSING SYSTEM IN MEXICO.....	70
Chapter Three – QUALITATIVE EVIDENCE ON RENTS, RENT-SEEKING AND RENT-EXTRACTION.....	98
Chapter Four – QUANTITATIVE APPROACHES TO RENTS FROM TRADE RESTRICTIONS.....	143
Conclusions -.....	183
Sources and Bibliography.....	188

List of Abbreviations

ABM	Mexican Bankers Association
AGN	National Archives
ALM	Adolfo López Mateos
AMIS	Mexican Association of Insurance Institutions
ARC	Adolfo Ruiz Cortines
BANXICO	Banco de México (Central Bank)
BMYR	Central Bank Yearly Reports
BNCE	National Bank for Foreign Trade
CANACINTRA	National Chamber of Transformation Industries
CCE	Business Coordinating Council
CMHN	Mexican Businessmen Council
CNC	Peasants' National Confederation
CONCAMIN	National Confederation of Chambers of Industry
CONCANACO	National Confederation of Chambers of Commerce
COPARMEX	Employers' Confederation of the Mexican Republic
DOF	Official Gazette
EHM	Historical Statistics of Mexico
FP	Free Perimeters
GATT	General Agreement on Trade and Tariffs
IMF	International Monetary Fund
ISI	Import-Substitution Industrialisation
MAV	Miguel Alemán Valdés
NAFINSA	National Financial Agency
PRI	Revolutionary Institutional Party
SIC	Ministry of Industry and Commerce
SHCP	Ministry of the Treasury
UNAM	National Autonomous University of Mexico

Cronies, rents and import licenses: non-tariff trade controls throughout Import Substitution Industrialisation (ISI) in Mexico.

1.- Introduction

It has long been acknowledged that Import-Substitution Industrialisation (ISI) in developing countries entailed redundant protection to a lesser or greater degree. Vis-à-vis their East-Asian counterparts, the “infants” of nascent industries in Latin America seem to have taken more time to reach adulthood: productivity growth in Latin America in general and in Mexico in particular stagnated in the late sixties and since then it has not matched that of South-East Asia. Trade protection in excess, far from being the only reason is nonetheless crucial to understand the meagre productivity growth from the late sixties onwards.

However, most of the literature on Mexico focuses either on the outcomes and rationale of ISI in general or on the structure of protection from a macroeconomic perspective, thus placing emphasis on the role of price mechanisms for protection –namely, tariffs. Despite a widespread acknowledgement in the literature in the sense that non-price trade controls (mainly, import licenses) played a crucial role in Mexico, (Balassa, 1971; King, 1970; Haber, 2006) research on the import-licensing system lacks depth and detail. Clear, hard evidence describing the interplay between such system and mostly politically driven protection is still missing.

That is why this project focuses on the core non-tariff instrument –the import licensing- and, by bringing the rent-seeking literature into the picture, approaches the issue in a novel way. However, this project is not an attempt to assess ISI in Mexico. Countless insightful works on this matter have been written elsewhere. The focus here is upon trade restrictions in general and import licensing in particular which, given their scale and scope, ended up being a brake to growth (not only raising the costs of trade but also by facilitating wealth *predation* or “rent-seeking” over wealth *creation*, to put it simply). As such,

import licensing connects with a larger theme: that of the pervasiveness of rent-seeking behaviour in Mexico throughout modern history. Rents are to be found everywhere: in –oversized, sclerotic- public-sector unions, private monopolies and oligopolies, petty and not-so-petty bribes and, as of late, the “boom” in the “extortion industry” in its myriad forms. Even the extent to which is embedded in the language (“*El que no es transa no avanza*”¹) attests how deeply ingrained *predation* is on the Mexican mind-set.

As a legal mean to obtain and secure rents, import licensing in particular also matters because it can easily evolve into self-sustaining rent-seeking: as long as it is profitable to both parties, it is unlikely that such device would be withdrawn *ceteris paribus*. Economists –even those not referring to “rent-seeking” as such- have repeatedly argued that licensing is the “black sheep” of trade-control instruments; to start with, the price difference accrues to the importer, not to the public purse as in the case of tariffs, and given that allocation rules are seldom clear, unequivocal and transparent, it brings, at best, difficulties for planning importation movements and outright rigging and corruption at worst.

Thus, the core research questions of this project can be summarized as follows: which specific pattern did import-licensing follow? Is there evidence that non-tariff trade controls were mostly driven by rent-seeking?

Overall, the core findings point toward an import-licensing system that was not only *internally* inconsistent –missing its own goals- but of little economic relevance (i.e., to either reduce the trade deficit or accurately calibrate the supply/demand dynamics for imports). If it served a purpose, it was to maintain redundant protection well beyond any rationale. In that, sense, what was clearly a short-term strategy became a rent-generating mechanism entrenched in the economy, with long-term consequences for productivity growth –though measuring the latter is beyond the scope of this project. Below, a brief summary of the historical context/historiography of the import-licensing system is presented, along with a note on theoretical definitions on rent-seeking and an overview of the core research chapters –chapters III and IV.

¹ “He who does not cheat, does not get ahead”

1.2.- Historical context and historiography of the import-licensing

The inception of the import-licensing system has to be traced back to the Second World War. Sharing a border with the US, Mexico –as opposed to the rest of Latin America- benefited greatly from the conflict as trade increased significantly. GDP per capita went from \$3,570 pesos (constant) in 1939 to \$4,165 in 1945. As income grew steadily and new industrial plants were set up to meet demand from the US, so importation soared: its growth averaged 22 per cent per year throughout the war period. In other words, both capital and intermediate goods, destined to industry, and final goods destined to consumption were being imported in record quantities. Not surprisingly, in 1944 the country faced a \$72.6 million dollar deficit after a string of small surpluses. It was the first balance-of-payments crisis in years. The central bank, on its yearly report, noted that:

“Huge quantities of chemicals entered the country; in consequence, to avoid an even more dangerous *invasion* the government found itself forced to classify those products as of requiring a license, given that they are already produced in the country” (BMYR, 1945:11 *italics added*).

This is the first mention to import licensing, which that year was applied only to a few chemical products and it was a transitory measure without any legal base as policy. What the report does not mention is that the chemical industry had just begun producing import-competing items, thus pressing the government to grant the industry some protection. Anyhow, the combination of an over-valued currency (the exchange rate was fixed), income growth and new industries pushed the deficit even higher: \$92.2 and \$255.3 million dollars in 1946 and 1947, respectively (Ortiz Mena, 1953:397). This was serious enough as to trigger a more co-ordinated strategy. The response was two-fold: first, a product’s tariff would be a specific nominal percentage plus the *ad valorem* percentage, with the added element of official prices to avoid tax evasion via undervaluation. Second, the government identified those imports deemed as non-essential –

“luxury items”- a broad category that included not only whiskey, red wine, cheese, ham, tobacco, jewellery, carpets but most vehicles as well. These items represented 18 per cent of the deficit in 1947 and were therefore forbidden. The “only” exceptions would be the licenses that the government –the executive branch- would grant at its discretion. The licensing system was thus formalized, and the executive office published in the DOF (*Diario Oficial de la Federación*) a decree entitling the SIC to include or exclude any item from the list of banned imports. (DOF, 24/04/1947).

By the early fifties, “Licensing Committees” were created to deal with industry-specific applications for imports. In theory, they would inform the Ministry as to what products include in the list and what licenses to grant, based on four economic criteria: i) the inexistence of an equivalent locally produced good; ii) the impossibility of local producers to meet total demand, iii) temporary scarcities, or iv) the need to have large stocks of raw materials and intermediate goods given a particular production process (*Secretaría de Industria y Comercio*, 1956). However, it should be noted that there is no mention whatsoever of the most obvious economic factor; namely, price –in line with giving industrialisation top priority. Also, the committees were composed by an officer from the SIC, the SHCP and industry appointees, leaving room to potential conflicts of interest.

This is even more relevant taking into account two facts: the sheer and ever growing number of applications (30,000 per month by the late sixties) and the legal obligation for the SIC to respond in ten days; furthermore, there was an acute problem of asymmetry as officials would never have as much relevant information as the people in industry. In addition, for many of them there was always the “last resort” option of contacting the Minister or even the President himself. In any case, the overall trend is straightforward: the total percentage of imports under licensing grew steadily and considerably, reaching virtually the totality of imports in the aftermath of the 1981 crisis.

Unfortunately, there is very little data published on the import-licensing system: the table below summarises most of the data available from secondary sources.

Table One – percentage of imports under licensing requirement

	1956	1957	1958	1959	1960	1961	1962	1963	1964
TOTAL	27.7	35.1	42.5	43.2	37.8	53.6	52.5	63.3	65.4
Food	18.8	4.4	66.7	25.6	28.2	46.7	65.8	83.6	64.1
Drinks and tobacco	45.2	47.6	34.2	20	33.1	23.2	99.9	100	99.9
Raw materials	23.4	27.5	39.6	36.1	39.6	41.1	71.1	68.3	62.9
Fuels and lubricants	4	40.4	39.5	95.5	91.8	87.6	92	86.2	83.6
Fats and oils	76.2	71.3	57.1	83.2	73.7	93.5	67	72.7	76.6
Chemical products	37.3	39.3	43.9	42.7	41.3	67.8	44.8	45.1	55.9
Manufactures	47.5	54.4	50	57.3	54.5	66.7	68.3	63.7	60.4
Machinery & equipment	25.3	36.1	39.5	42.3	33.4	50.1	48.6	67.6	71
Manufactured goods	8.5	12.8	16.8	17.6	15.7	21.5	28.3	27.4	30.4
Arms and munitions	44	45.1	36.9	51.3	52.8	79	18.4	56.4	36.1

Source: Balassa (1971)

Both economists and economic historians agree on the inconvenience of this trade-policy instrument in general and the opportunities for rent-seeking in particular. Bela Balasa (1971) in his authoritative work on the structure of protection, argued against the widespread view –amongst developing countries– that such system allows for rapid action on the part of the government. On the contrary, he notes: licensing not only makes bureaucracy bigger but, given the extent of arbitrariness, (the “case-by-case” approach) the whole process creates too much inequities as well as uncertainty. Firms cannot plan ahead in such context, which means higher costs for the economy. In short, it imposes high transaction costs that add up for the whole economy. But even more important are the profits that come with the licenses:

“The profit obtainable from licenses not only induces a diversion of productive effort but also provides incentives for bribery that may be looked upon as a “sharing” in this profit. Moreover, vested interests are created to perpetuate the system of quantitative restrictions. As quota recipients try to avoid sharing the spoils with new entrants, they resist changes in the system of protection” (Balassa, 1971:92)

So it is clear now that in addition of transaction costs there is the problem of *diversion* of productive efforts and *bribery*. Rafael Izquierdo, who worked in the Mexican government and published the most influential paper on import licensing in Mexico also noted the severe problem of asymmetric information:

entrepreneurs had not only relevant data but they knew exactly how to profit from trade protection. In contrast, bureaucrats lacked the most basic information about industries such as cost structure, scales, elasticity, and profitability; in fact, by the late fifties the government started using the import committees to get as much information as they could. But, again, Izquierdo points out to the relevance of networking:

“All these circumstances combine to increase the importance of direct contacts between individual entrepreneurs and government officials. These contacts determine the strength of the individual businessman’s position in relation to both the government and rival entrepreneurs. Many facets of these personal contacts are extremely subtle” (Izquierdo, 1975:259)

The licensing system survived two major economic crisis -1976 and 1982- because the government would exhaust all options before recurring to the much-feared devaluation –although the extent of the peso overvaluation was simply too high for trade controls to make a difference. It also survived the first attempts to join the GATT (General Agreement on Trade and Tariffs) in the late sixties and early seventies because, tellingly, industrialists did firmly oppose the move. It would take two crisis and substantial shifts in political conditions for the government to join the GATT and therefore to dismantle the licensing.

Closely related to protectionism –in fact, a direct consequence- is the question of smuggling: by widening the gap between domestic and international prices, incentives to get round of trade restrictions are greatly increased –and this of course includes bribes and other illegal practices, which can become self-sustaining. Increased red tape, rules and requirements only court corruption in general and extortion in particular. This is a well-known fact from the rent-seeking literature, but it was clearly expressed by the Secretary of the Treasury, who in 1951 lectured –in a polite manner- the custom officials:

“There is the impression (amongst businesspeople) that, quite often, procedures are unnecessarily taxing, sometimes because of petty corruption, sometimes because of inertia... Or, people say, with the aim of creating new requirements that justify extended hours of work or other barely legitimate means to charge the public extra money for the service in question (...) It is something that we hear constantly: that in the customs, bribes are asked in exchange for this or that service.. people talk about this, and so a reputation is formed (...) To this situation, which already existed, it has been added the challenge of implementing the decrees concerning import restrictions, which only worsens the situation because it only increases the incentive of those who want to get merchandise through” (Speech by Ramon Beteta, 1951; in: *Memorias*, SHCP, 1951:251)

The restrictions of 1951 literally dwarf in front of those of the mid-sixties onwards: the complaints about the customs would become recurrent theme among business groups; the outcome –all the smuggling- even inspired a new word in the local markets: *fayuca* (smuggled merchandise). Twenty years later, another economist would comment on the subject of smuggling:

“In any event, as a last resort, there is always contraband. The amount of smuggling is obviously not known, but a very large number of stories circulate about it. Apart from the error and omissions term in the balance of payments, which may include the purchase of contraband items, many products legitimately imported into the border areas under the concessions allowed to these regions are brought to the interior. No doubt smuggling limits the ability of domestic manufacturers to charge much higher than the US prices, but there is no suggestion that this wrecks the efficiency of import-license system.” (Vazquez Tercero, 1966:53)

In other words, the licensing would only make smuggling even more attractive (especially for those items completely excluded from importation). Thus, it can be conceptualised as a by-product, or proxy, of the extent of redundant protectionism –as such, it is analysed in some detail in Chapter Four.

1.3.- A Note on the theoretical framework

Before presenting the outline of the chapters, it is worth explaining the basic concepts and assumptions stemming from the rent-seeking literature. The core

concept of *rent* can be understood, first and foremost, as any “excess” payment in the sense of being *unnecessary* to induce production: the monopolist would still be selling output under a more competitive scenario, so the “extra” profit is, in a sense, circumstantial, since it is a transfer from consumers to the producer that has nothing to do with the goods being traded themselves.

Now, the whole point of the neoclassical rent-seeking approach is that such transfer –harmful to consumers as it might be- is neither too big nor substantially damaging to the economy *as a whole*; ultimately, it is about all the resources –monetary and otherwise- diverted in order to obtain, secure or defend a transfer that, over time, will have returns above productive activities.

That is to say, rent-seeking is about rational agents that see and seize opportunities for wealth *predation*, instead of wealth *creation*, which government policies can, inadvertently at best, facilitate: “The modern rent-seeking literature describes the rational decision to invest in contesting pre-existing wealth or income, rather than undertaking productive activity” (Congleton, Hillman and Konrad, 2008:4)

Another, now classic, definition is also clarifying: “*The resource-wasting activities of individuals in seeking transfer of wealth through the aegis of the state*” (Buchanan, Tollison and Tullock, 1980:2). As such, it includes monopoly rents *strictu sensu* but goes well beyond those: any economic entitlement of value to the holder. It should be noted, though, that the condition of “*through the aegis of the state*” does not necessarily mean it should be legal; it is simply implying that the *source* of the entitlement would be the state, but the means could be any -the only difference with outright theft and/or crime would be the absence of physical violence.

In a similar context, Krueger notes that: “*when quantitative restrictions are imposed upon and effectively constrain imports, an import licence is a valuable commodity*” (Krueger, 1974:291). Needless to say, this is the conceptual basis for the link between import licenses and rent-seeking behaviour.

1.4- Structure of the thesis

Chapter one is the literature review. As such, it expands the already presented historiographical framework of the import licensing –it is scant, but that is precisely a core reason to do the research. Second, it briefly reviews the core elements of the

political system in Mexico after WWII and it analyses its salient features. Third, and last, it reviews the extensive rent-seeking literature, and it draws some implications for the research itself, taking into account both the orthodox and heterodox approaches to rent-seeking.

Chapter two is a background chapter. It presents, describes and analyses the performance of the economy in general and of trade –and trade policy- in particular. It does so by reviewing both secondary and primary sources (primarily, yearly reports from the central bank -BANXICO- and by presenting basic statistics on the relevant indicators.

Chapter Three and Four can be considered as the core chapters of this thesis, and are entirely based on primary evidence gathered in the National Archives (AGN) in Mexico City and, in the case of the fourth chapter, complemented with statistics from primary sources. The former presents the qualitative evidence, while the latter the quantitative one.

For Chapter Three, the documents found in the AGN related to import licenses can be classified as follows: i) letters submitted by private firms asking for tariff protection and/or import licenses/quotas, ii) requests for import permits for inputs, iii) internal documents from the SIC assessing specific cases and requests, iv) letters from officials who, for various reasons, wanted to disclose information about particular cases and, importantly, v) letters received and sent by the Office of the President. It should be noted that the selection of cases/industries was determined by availability of information: these are the only materials related to the licensing found in the archives. Rather unfortunately, the vast majority of documents covering the actual granting were simply lost or destroyed.

From the materials found, it was possible to re-construct 9 cases (9 industries) plus an interesting account on the rents extracted in the Custom of Acapulco. Overall, what this cases show is the arbitrariness of the policy: of two (or more) firms competing for the same permit, it is the one affiliated to the PRI (the one and only political party by the time) or with close connections –with Senators or Generals, for instance- that would get the license in record time. In stark contrast, less “connected” firms would have to wait between 2 and 4 months for a (negative) answer, on grounds of “the strictest economic analysis”.

In seven cases (fruit traders, poultry & eggs, gloves, linoleum, tin plates, ancillary industry and automobiles) the applicants sought and got the competing imports banned through the inclusion of the item in the “licensed” list, thus accruing monopoly rents -at the expense of consumers. They lobbied not only to include the item on the list but to ensure that no licenses would be granted. Price increases ranged from 20% -the lowest- to a full three-fold spike. Interestingly, in the case of products that are themselves inputs –tin is the best example- the government had to grant some licenses after realizing that those rents were being transmitted to the general price level. This case also epitomizes the conflict, where powerful producers would clash, while the government would try to make everyone happy (everyone who happened to be a producer, that is).

The other three cases –Soap Industry, Agricultural Exports and Submersible pumps- are perhaps even more interesting as they show how licensing would also shape the relative position of some firms within the same industry: instead of being at the expense of consumers at large, rents are accrued at the expense of those firms whose costs raise faster than the ones with “links”.

The quantitative analysis of the import licensing, as it was originally planned, would have included the yearly numbers of licenses granted/rejected, per item, per firm and per industry. This would have made possible the identification of patterns and, in turn, the extent of correlation with movements of the trade deficit. Moreover, it would have allowed for a test regarding an *inverse* correlation between license granting and profitability –for final goods- and a *direct* correlation between license granting and profit margins for inputs and intermediate goods.

Rather unfortunately, after two visits to the archives it was clear that such data was not to be found. However, it was still possible to construct a database by collating all the decrees (3,754, to be precise) from 1947 to 1981 that declare a particular item as banned from importation without a license. Crucially, this allows for an assessment of at least the internal consistency of the licensing: with the data after 1967 (once the decrees started including a time limit) it is possible to extrapolate the expected reversals (that is, items that should be imported freely again) with the observed ones. The results show a staggering lag between the former and the

latter; that is, not even when the government committed itself to dismantle protection such action took place.

A natural consequence of over-protection is increased incentives for smuggling; in turn, it provides opportunities for rent-seeking for both smugglers and corrupt officials. That is why Chapter Four also deals with it: it provides a rough estimate of overall smuggling by comparing the data on American exports to Mexico with the data on American imports to Mexico –the former are consistently higher in value than the latter: all throughout the period 1947 to 1976, in both absolute and relative terms.

The third test is an overall analysis of the importation to Free Perimeters² (FP); descriptive statistics of their growth and magnitude, as well as comparisons vis-à-vis general importation using per-capita standardizations show that such special areas were used as a source of cheap imports that would be smuggled into the rest of the country –effectively generating rents and, sadly, feeding the well-established channels of corruption and perverse incentives.

All three tests point toward a simple fact: trade controls were neither effective nor, in the long run, sustainable.

² These were special areas along the border with the US exempted from trade protection, initially to compensate for the lack of economic activity (see Chapter four)

2 CHAPTER ONE

Literature Review

ABSTRACT: The aim of this section is three-fold. First, it provides historical and historiographical context by describing the dynamics of Mexican business politics; second, it reviews the historiography on the import licensing system as such, and links it with broader themes of the political economy of industrialisation. Third, it reviews and summarises the broad literature on rent-seeking, from the neo-classical theoretical foundations to more empirically-based, heterodox approaches. It concludes establishing the methodological implications for analysing the evidence.

2.1 Introduction

Back in 1945, an enthusiast Mexican industrialist wrote a short text making a case in favour of industrialisation as a patriotic duty. Moreover, he wanted to convince his audience –the business community at large- that such a patriotic task was worth a few sacrifices: “All means of propaganda must be used... to induce the consumer to accept and to prefer domestic products. In this sense a true national viewpoint has to be created. This will help to convince consumers that any immediate *sacrifice* caused by the purchase of domestic goods, even if they are of *lower quality and higher price*, will be compensated in the future by economic independence for the country and a substantial rise in the standard of living of the whole Mexican people.” (Colín, J. [1945] quoted by Mosk [1950:38] italics added) The question on whether such sacrifice eventually became unjustifiable is, a sense, the central theme of this thesis: was trade protection –via non-tariff mechanisms- abused by domestic producers?

A larger theme could also be described as follows: from theoretical (Krueger, 1974, 1990, 2002;) and empirical insights (Haber, 1989, 2002, 2006; Khan, 2000) it is known that industrialisation processes in developing countries have usually implied rent-seeking to some extent, usually because rents were a powerful incentive to engage the private sector in long-term investment –at best- or simply because the political system was weak and vulnerable to lobbying and outright corruption. However, if rents keep growing up to the point of getting into a self-sustained cycle, where bigger rents afford even more rent-seeking, the industrialisation goals are undermined, given higher costs to local producers (and consumers at large), efficiency and entrepreneurship losses, lack of technological innovation, etc. –not to mention increased incentives for defending those rents. In addition, successful rent-seeking

means that some businesses will gain at the expense of other entrepreneurs, who will in turn try to change the way rents are being allocated.

Thus, as industrialisation deepens, rent-seeking gains strength –it gets competitive, in Krueger’s terms-, roots itself in the economy and imposes higher prices to both consumers and producers. Isn’t then potential growth affected? Therefore, if industrialisation entails rent-seeking and rent-seeking poses a real threat to growth, what would be the government’s response? On empirical grounds, it means finding at what point, or in which cases, policy-makers and politicians backed a reversal in the strategy –which would heavily rely on protectionism- and allowed (or threatened allowing) imports again? Was there such a thing as government’s retaliation?

The problem is even more complex considering the second “stage” of ISI when the goal was substituting both final and intermediate goods; however, most capital goods –and some key raw materials- would have to be imported anyway, posing a huge administrative challenge: channeling imports in the right quantity to the right firms, while blocking general importation. In this context, import licensing has two straightforward effects: to protect import-competing domestic goods (via the inclusion of the given import into the license-required list) and/or to get access to crucial inputs (through an actual license to import banned items). Firms producing final, manufacturing goods or those relatively dependent on inputs from international markets will be willing to invest in such permits. That is why import-licenses are a favorite topic within the neo-classical rent-seeking literature: a license is a valuable and relatively “easy” rent to be captured: it is issued in such a discretionary way, and the potential benefits so great that it is worth investing some resources –monetary and otherwise.

2.2 A note on Mexican Business Politics

Having stated that the import licensing was not only a core trade-policy instrument but also a potential source of rents for the private sector, it is essential –before analysing the licensing mechanism in more detail- to frame the discussion also in terms of the relationship between business and the state, including specific actors on the two sides. This is both a central preoccupation of political scientists in general (which overlaps with the rent-seeking literature) and of the political science literature on Mexican politics in particular –for instance, Vernon (1963; 1964), Reynolds (1970), Bailey (1986) and Vellinga (1989) - that emphasises the closeness of such relationship. Furthermore, Maxfield and Schneider (1997) and Schneider (2004) analyse the determinants and outcomes of those strong links, while Valdivia-Machuca (2005) also by focusing on individual private-sector players –semi-official and independent business organisations- stresses the crucial role that informal institutions and networks played: what he labels the ICES (Informal Consultation and Exchange System)

At a theoretical level, the rational and public choice strands of the political science literature have a common suspicion -along with the rent-seeking framework- against bureaucrats who, it is thought, would simply maximize self-interest rather than pursuing the common good. Mancur Olson’s (1982) well-known elaboration on the “distributional coalitions” is a core example of this position and his framework has been widely influential in subsequent analyses of politics and politics in developing countries. In this line of argument, it is the capitalists and their allies who form the so-called distributional coalitions to pressure the government to divert resources to themselves (in detriment of society’s welfare). According to Olson, the smaller the numbers and the more homogeneous the members of a given organisation/coalition, more likely collective action will take place; “selective benefits” are also a powerful driver of action. As Schneider (2004) points out, this is a useful starting point yet it falls short of a comprehensive approach: by over-stressing the immediate dynamic of negotiation and bargaining, it neglects the context; the state is therefore reduced to a mere reactor to private demands –when the evidence is overwhelmingly the opposite. “States organized and disorganized business” (Schneider, 2004:5).

Even before the framework of rational/public choice would become influential, many American researchers on Mexico highlighted the incentives for and the evidence of strong co-operation between business and the state in the context of late industrialisation. What Vernon (1963:193) labelled as “the alliance for profits” and Reynolds (1970:186) co-operation with “mutual advantage”. At any rate, there was agreement regarding the extent to which it was a fluid relationship; Vernon states that “extensive ties between public officials and private interests are part and parcel of Mexican life (...) most government policy goes *sub rosa*, beyond the ken of newspapers and the public” (Vernon, 1964:153-4).

Later works - Maxfield and Schneider (1997) - acknowledge this but, crucially, build a case for business-state relations that can be growth-enhancing, as opposed to the pessimistic view offered by rational choice theory in its purer forms. Maxfield and Schneider emphasise that it is about particular *conditions* which lead to a collaborative relationship, instead of “degenerating into collusion and rent-seeking” (Maxfield and Schneider, 1997:5). They acknowledge the importance of a *Weberian* bureaucracy –“an insulated, meritocratic bureaucracy is a first bulwark against corruption” (Ibid) -although they reckon that such bureaucracies are rather scarce across the developing world, so they shift the focus to self-policing business associations and encompassing firms relations –along with state capacity- which ultimately make growth-enhancing collaboration more likely. There are also real threats against opportunism; namely, economic competition –to business- and political threats to the survival of state actors.

These authors describe four critical features that shape the nature of state-business relations: Information exchange, reciprocity, credibility, and trust. Business chambers and organisations are instrumental for the flow of information which is essential to policy-planning and policy-making; transparency in general, as well as transparency in the distribution of rents –for instance, opening close bids for utility- do significantly reduce the incentives for rent-seeking. However, given the nature of late-industrialisation processes, reciprocity is even more important to achieve a growth-enhancing relationship: if the state gives away subsidies –or rents, for that matter- but it is not able to exact performance standards from firms, or bails out troubled firms only because of their sheer size, it is then inviting “abuse” (Ibid:10). Lastly,

credibility and trust dramatically reduce transaction and monitoring costs, and encourage higher investment rates in the long run. Collective business action - through associations- was instrumental in order for credibility and trust to contribute positively and to minimise incentives for rent-seeking.

Schneider (2004) elaborates further regarding Latin America in general and Mexico in particular. In the former, throughout the twentieth century, state actors were the “causal agents” of business organization. Top officials in the economic bureaucracy, more often than not after a crisis, enacted policies that helped business organise, sometimes as an unintended consequence of threatening policies that promoted short-term defensive organisation; moreover, an extensive use of the so-called selective benefits –material benefits and privileged access- held the encompassing associations together. Crucially, such selective benefits were even more important in a context where other options for political participation were closed (Schneider, 2004:13).

In Mexico’s case, Schneider addresses the well-known greater organisation of big business by using the “love-hate” metaphor for its relationship with the state. First of all, the “hate” factor stemmed from both overt state threats and specific policy shifts which were detrimental to business (which in turn were concessions to mass actors, namely labour), for instance in late 1920’s, late 1950’s, early 1970’s and early 1980’s, when big business responded to such threats by creating and/or strengthening voluntary associations. In post-crisis times, state actors offered these organisations privileged access to policy-makers in order to gain their support –otherwise the implementation of state goals would have been virtually impossible.

Both Schneider (2004) and Valdivia-Machuca (2005) make the distinction between corporatist or “semi-official” business organisations, created by the state as early as 1920’s and voluntary or “independent” business associations which both authors identify as crucial to understand relations with the state –albeit with different emphasis. Even the voluntary organisations received decisive support from the state (mostly through privileged access) and almost all had formal channels of interaction; “more important, though, were the informal, though routine, mechanisms of access, mostly through ritualized lunches and dinners, between representatives of government and business associations.” (Schneider, 2004:60).

There is also agreement regarding the classification of such organisations: on the semi-official category, three over-arching organizations are to be found: CONCANACO (National Confederation of Chambers of Commerce), CONCAMIN (National Confederation of Chambers of Industry) and CANACINTRA (National Chamber of Transformation Industries), while amongst the voluntary ones, three major and two minor ones are of relevance: COPARMEX (Employers' Confederation of the Mexican Republic, CMHM (the Mexican Businessmen Council), CCE (Business Coordinating Council) in addition to two banking-related associations –ABM (the Mexican Bankers Association) and AMIS (the Mexican Association of Insurance Institutions).

Even though all three semi-official organisations were created as a result of state corporatism, they did not evolve in the same way. CONCANACO was created in 1917 mostly as the government's effort to deal with the disruption in the economy after the revolution and the First World War –which meant shortages and severe price fluctuations; however, only after the Law of Chambers of 1936 and 1941, which made participation and dues mandatory, the other two organisations gained true relevance. As Schneider notes, government officials encouraged business organisation to generate political support, reduce opposition and aggregate business preferences in a context of ambitious economic goals. CANACINTRA, itself formally only one out of sixty CONCAMIN's members, had half as many members –from 93 firms in 1941 to 18,000 in 1960- and twice as much budget. Virtually all new manufacturing firms were represented, precisely the ones to gain the most from trade protection: “The creation of CANACINTRA demonstrated astute political engineering by state actors who manipulated corporatist regulations to amplify the voice of industrialists who supported the government strategy of state-led ISI” (Schneider, 2004:64). In exchange for access to government officials, CANACINTRA publicly supported the government in its economic agenda, embracing a nationalistic discourse and highlighting in the public arena the modernising character of the industrialisation strategy as well as the economic independence that the country would achieve.

Interestingly, while the ABM was also created after encouragement from the government in 1928 and would become one of the most elite associations, COPARMEX was formed a year after as the initiative of businessmen from the

northern city of Monterrey, traditionally pro-business, and as response to the labour laws enacted by the government –concessions to increasingly powerful urban workers. Throughout the twentieth century, COPARMEX would act as the only overly free-market, open critic of the government. Given the power of their members –the industrial groups of Monterrey, including many of the oldest firms in the country- the government could not afford to ignore it; eventually, COPARMEX was given selective benefit of access in the form of a seat on the boards of public entities –especially wage and labour commissions- and the more “informal habit” of consulting it before major policy shifts.

However, opposition to labour laws was far from being the only cohesion factor for business: as the episodes regarding the creation of the CMHM in the early sixties and of the CCE in the seventies respectively show, the combination of exclusion from positions of power in the government and perceived threats from the state had a remarkable effect. Schneider highlights the fact that, while labour leaders had at least access to medium-ranking legislative, party and ministerial positions, such channels were entirely closed to business people, a highly unusual feature of Latin American politics. In addition, by the early sixties President López Mateos had made clear not only his interventionist take on economic policy, but also his self-described “leftist” character along with his support for Communist Cuba (Valdés Ugalde, 1998:142). Thus, the CMHM was initially created to channel opposition, to get reassurances from the President and even to assuage fears of investors in the US. Over the years, it became a very discreet yet powerful group which would hold regular lunches with the President and other politicians. At any rate, the fear and opposition to Echeverría in 1975, who had a clear anti-business rhetoric and agenda proved far more effective in uniting not only business people of COPARMEX and CMHM but even sectors already represented through the corporatist organisations such as CONCANACO and CONCAMIN, plus the finance sector through the ABM and the AMIS. As such, it was by far the most encompassing peak association Mexico had even seen, and collective action was indeed effective: Echeverría had no option but to take it seriously and engage in dialogue.

In sum, Schneider emphasises how -on the one hand- state corporatism organised business through associations that would facilitate political control and the

implementation of industrialisation policies; on the other hand, he stresses how the state –by threats to business’ interests- created common interests. Even if governments attempted to isolate some sectoral association, that only enhanced incentives for business to take collective action –by engaging with more encompassing peak associations (Schneider, 2004:92).

While acknowledging the role business organisations and, in particular, the effects that political exclusion had upon business groups, Valdivia-Machuca (2005) focuses on the ICES or networks of individuals built around the President plus the six most important Ministries/Secretariats. In doing so, the author is in line with Vernon’s argument: “the humdrum efforts of single enterprises and small groups of companies –operating within an existing framework of laws, regulations, contacts and friendships- to obtain government credit, tariff protection, sales contracts, tax exemptions, import licenses, and the like” (Vernon, 1963:155). By the same token, Valdivia-Machuca shows that the public and private sectors were linked mostly through an integrated system of policy networks, that such networks influenced behaviour through regulative, normative and cognitive mechanisms and, crucially, that they created certainty. As he puts it: “all sources appear to confirm an informal system that regulated much in private-public relations (...) Additionally, the system was based on agreements that entailed high degrees of trust and mutual enforcement, while at the same time provided valuable channels for exchange of information and resources.” (Valdivia-Machuca, 2005:76)

Besides the obvious importance of the President and his secretariat, the author highlights the networks around the SHCP and the SIC, explicitly mentioning that the latter was in charge of price controls and import licenses (Ibid:78). It is thus clear that both collective action and informal networks did compensate for the lack of political access for the business community.

Lastly, the business politics picture has to be rounded with a word on labour politics - not only because it is, by definition, an opposing interest to business, but also because the Mexican political regime had emerged from a social revolution and there were indeed strong demands for redistribution and socially-oriented policies. As Middlebrook (1995) notes, the Mexican regime would have to broaden popular support while, at the same time, imposing significant constraints on mass

participation in order to hold power; that is, simultaneous centralisation and legitimacy. The key to understand such paradox, according to Middlebrook, is the role of labour and its alliance with the regime. "Because of workers' importance, the revolutionary leaders striving to consolidate their political control and implement the revolution's agenda were compelled to adopt innovative strategies both to mediate labour participation in national affairs and to regulate the social relations of production." (Ibid:5)

At its core, it was the regime's effective control over the means of coercion (along with the willingness to use force when necessary) and the benefits to labour of linking itself with the hegemonic party and the interventionist state through official labour organizations. Therefore, the alliance would be appealing enough to both sides: rank-and-file workers would gain material benefits –pensions, subsidised housing and credit, health care-, their leaders would enjoy official positions and access to public funds with virtually no accountability- while the political elite would be able to constrain economic demands and worker mobilization during delicate times. Furthermore, the state reinforced the alliance by making it virtually impossible to have independent and democratic unions (by requiring state-sanctioned approval and so on). In fact, there were very few rank-and-file challenges to such alliance (Middlebrook, 1995:291).

Clearly, the co-optation strategy was a common element in the relations with both business and labour; however, precisely because of collective action constraints and effective displays of coercion from the state, independent/voluntary unionisation was virtually non-existent. In other words: relative to business, labour got far less effective access to policy-making, but more actual material benefits –for the workers at large until the Second World War, then onwards mostly for the leaders. Nonetheless, CANACINTRA, with the support of the official unions, would remind the public from time to time that imports equaled job losses, so these should be avoided at all costs. On the other hand, the over-reliance of co-optation, in addition with the identification of CANACINTRA with the industrialisation goals meant that the only real threat against opportunistic behaviour –that of economic competition, as in Schneider and Maxfield (1997) - was seldom exercised.

2.3 The Import Licensing –and the political economy of industrialisation.

As already mentioned, it was in 1944 the first time the government imposed restrictions to the importation of chemical products. However, it was until 1947 when it was enacted as policy –by decree- only to be ratified in 1951 and 1954, when the total imports under control went from 18% to 27.7% (King, 1970:77). The policy of import licensing, managed from and approved by the SIC remained unchanged until the eighties. What changed, or could change at least in theory (see Chapter 4) was the actual “list” of products requiring a license.

From the literature on Mexican industrialisation and trade policy (Balassa, 1976; Cardenas and Thorp, 2003; Bueno, 1970; Izquierdo, 1973; Story, 1986) it has been established that import licensing was prominent among industrial and trade policy instruments. From the onset, the government acknowledged this –arguing the effectiveness for both retaining foreign currency *and* protecting domestic producers- as it is stated in one of the first official assessments of the overall industrialisation strategy (NAFINSA, 1971) in which it is stated that import-licensing was, after tariffs, the single most important instrument for trade control: 65% percent of the total value of all imports was brought in through this system by the time of the report’s publication (1971) and two-thirds of all tariff categories were subject to licensing (NAFINSA, 1971:270); this percentage would only increase, reaching virtually all imports between the 1976 and 1982 crisis.

The report also acknowledged that import licensing was an important source of revenues for the Ministry of Finance since its inception in 1947, making clear that the government was unlikely to abandon this practice. In addition, the cumulative effect of the policy has been stressed (Izquierdo, 1973) repeatedly: very few products were taken out of the list once they were classified as requiring a license. As a consequence, the case-by-case basis by which import-licenses were granted meant that businessmen “intervened in the process in a profound and continuous manner” (Izquierdo, 1973:239). The Cambridge Economic History of Latin America refers to the same point in the following terms:

“From the point of view of the governments, such permit systems were advantageous because permits could be used as a patronage to maintain the loyalty of the individuals who were doing the importing. Like most protectionists policies, these began on an ad-hoc, temporary basis. Consider, for example, the Mexican experience. Facing enormous pressure on its trade account, the Mexican government imposed quantitative restrictions on imports in 1947. At first, the restrictions only applied to luxury goods, but a year later the ministry of the national economy was given authority to increase the range of restricted goods –the only request being that it had to first consult with the secretary of the treasury to assess the impact of the restriction on government revenues. As a practical matter, this meant that manufacturers could lobby the executive branch of the government, which could then, without the need to seek legislative approval, restrict the importation of competing products. During the 1950’s these mechanisms were used to obtain quotas on a wide variety of domestically produced goods. AS soon as a new industry appeared, the government provided it with import quotas” (Haber, 2006:575; in CEHLA, 2006)

It is worth emphasising the political setting of the decision-making process: legislative approval was not required so there was no external body overseeing the SIC decisions. Furthermore, the decision process was prone to influence by its own nature: it rested on “Licensing Committees” in charge of preparing a technical assessment on whether a particular import license should be given, based on four criteria: i) the inexistence of an equivalent locally produced good; ii) the impossibility of local producers to meet total demand, iii) temporary scarcities, or iv) the need to have large stocks of raw materials and intermediate goods given a particular production process (SIC, 1956). Three elements of such system should be highlighted: first, not even in paper there is mention of the most obvious economic factor: price. Second, by law, the committees were formed by an officer from the SIC, another from the SHCP and industry appointees, creating potential conflict of interest. Third, the executive could override at any given time a decision made by the SIC.

King (1970), describing the import licensing system, implies certain *obscurity* of the system by making clear the lack of statistics on both the licenses granted in general and the committees’ activities in particular: “Applications from private manufacturers to the SIC, which operates the import control scheme, have probably been more important (than public-sector applications) There are, however, no statistics on this, nor on whether applicants are simply manufacturers anxious to consolidate their

domestic position, or potential industrialists (...) The committees meet frequently, generally twice or more a week. There are no published statistics on the operation of these committees, neither any available record of proceedings. The number of licenses granted, however, has recently been approaching 3,000 a week. There is no indication how many are turned down, but it is clear that the amount of time that any committee, meeting perhaps two mornings a week, can give to one application is limited” (King, 1970:78)

Subtly but clearly, King is suggesting that there were powerful reasons that accounted for such secrecy –and especially the *discretionary* nature of the instrument: there were general guidelines, but wide enough –though King is cautious to note that such flexibility was also put to good uses. Besides the potential corruption at the committees themselves, King (Ibid) and Maneschi and Reynolds (1966) make clear that the official reason to implement the system –the trade deficit-fails to explain the licensing decisions: it should be seen more as a tool for industrialisation.

All three Mexican specialists in trade policy during industrialisation (who, at some point or another, worked within the SIC) that is Gerardo Bueno, Rafael Izquierdo and Hector Vazquez Tercero pointed out the major risks of such discretionary policy. Bueno concludes that “the experience with these instruments shows a complex situation. On the one hand, diverse industries have been created taking advantage of this but they subsist only in anti-economic conditions or because of their monopolistic situation (...) on the other hand, over-protection has gone beyond reasonable limits and therefore it has contributed to the persistence of inefficiencies and the lack of a healthy competition” (Bueno, 1976: 223). Vazquez Tercero elaborates even further:

“Beyond any doubt, import controls grant industrialists a captive market. Furthermore, all controlled items have, in addition, excessively high tariffs. This way, manufacturing firms obtain maximum protection against imports –some of them while already been under tax exemptions. Many of the objections against the trade policy are indeed imputable to import licensing: by vanishing, or at least lowering competition, it doesn’t improve productive efficiency, given that industrialists know that, once an agreement for blocking imports has been reached it is unlikely to be derogated. Frequently, it also seriously constrains

the supply of key inputs whose importation is under control, in itself the outcome of some other industrialists' obstinate attempts to produce what they are not capable yet to produce (For instance: 'the industrial members of the Committee try, by all means, to avoid the importation of items that fall into their business-related areas, and it is sometimes the case that the firm represented in the Committee have neither experience nor enough practice to fabricate particular items, especially if these are unknown'[Mayoral Gasio, 1961:28]) In sum, there is no coordination whatsoever between this policy instrument and other industrial promotion instruments" (Vazquez Tercero, 1966:98; the original in Spanish)

In short, there is no disagreement in the literature with respect to the licensing as a device that would ensure domestic producers a market virtually free from foreign competition. Now, it is worth asking about domestic competition: would the government actually be interested on restraining monopolistic practices amongst domestic players?

The short answer is that the government showed great reluctance to enforce anti-trust legislation throughout the twentieth century. The 1917 Constitution explicitly forbids monopolies and monopolistic practices and warns that authorities will prosecute any infringement. The Article related to this was later ratified in 1937 (also known as the "Monopolies Law") but it was not until 1993, in the context of trade liberalisation, when the government took the step further from a loose set of principles to a well-defined competition law, supported by legal enforceability. The standard explanation, especially among American scholars (Reynolds, 1970; Wright, 1971; Hansen, 1970; Vernon 1973) points out to the fact that the government never considered competition to be a priority, and other considerations –namely, the establishment of new industries and employment- were far more important, to the point of pursuing them at the expense of competition. In Wright's terms:

"The Mexican scheme for the regulation of monopolies and restrictive trade practices is relatively unsophisticated and of very limited application. While the Constitution lays down broad principles for the protection of free and unrestricted competition, those principles have been largely sacrificed in favour of what are considered more compelling economic policies and the requirements of Mexican economic development. Some government policies have, in fact, deliberately limited competition and fostered monopolies by protecting domestic producers against competing imports and even, in some cases, against the establishment of additional local producers" (Wright,

1971:187) (...)

“Despite the rather broad authority under the monopolies law, the government has made very little use of it as an instrument for the control of restrictive trade practices. In many cases prices are controlled by other means so that there has been no need to use the monopolies law for that purpose. Furthermore, during some periods the desire to promote industrialisation, even where a monopoly resulted, has outweighed other considerations. Until recently government policy, enforced primarily by the Ministry of Industry and commerce by the virtue of its control of imports, has been to permit the entry of only a limited number of producers in an industry. Since about 1965, however, the emphasis has shifted to the promotion of competition as a means of encouraging greater efficiency and reduction of prices of manufactured goods, and, with few exceptions, the entry of as many producers as want to establish facilities in Mexico has been authorized” (Ibid: 191).

The implication is somewhat clear: if the government had “broad authority” but in practice did not enforce the monopolies law, it is very likely that the benefits for not doing so were large. In this quote, Wright suggests it was a matter of the “requirements of Mexican economic development”, but a re-interpretation from political economy and the new economic history (as in Haber, 2006) suggest otherwise: not only politicians would have gained very little from enforcing the law (given the lack of organization and electoral representation of consumers): the gains from not enforcing it were probably many times bigger. At least, this is what rent-seeking theory (see below) would suggest: if monopoly rents are substantial, economic agents will be willing to spend equally substantial amounts on maintaining them.

From the second quote, it is worth emphasising that Wright notes the “shift” in public policy as a reaction to high prices of manufactured goods. It does not necessarily mean that the government succeeded in reducing rents (thus prices) but it makes clear that some kind of reaction was taking place in the government. Indeed, President López Mateos declared in Sept. 2, 1961: “We have decided to lower tariffs and to abolish import licenses for some industrial products and basic inputs whose domestic prices were outright and without reason higher than external prices. The government is willing to pursue this policy as long as domestic producers and merchants’ actions tend to erode purchasing power” (Excelsior newspaper, Mexico City, Sept. 2nd, 1961 italics added). To what extent this reversal effectively reduced

rents and rent-seeking is unclear, but very unlikely in the long run since subsequent presidents would never be as determined as López Mateos.

Reynolds (1970) speculated about it, but was unable to present any evidence backing the claim that a shift in import policy was the government's answer to an excess of monopoly rents:

“More mature firms that have already gone through a several-year probation period and still do not produce at reasonable prices or provide adequate service to the customer may be threatened by government retaliation in the form of newly granted licenses for competing imports. This threat, together with internal competition among producers, is designed to reduce the danger of monopoly profits and restraints on trade that have otherwise resulted from the quota system. It is not clear whether the possibility of granting import licenses to break monopolies is a more effective instrument of antitrust policy than the threat of tariff reduction” (Reynolds, 1970:222)

In short, both the historiography and historical facts back the hypothesis that at some point rent-seeking was seriously threatening the economy's viability, to the extent of generating a government's response –at least at a discursive level.

As mentioned above, the problem is even more complicated when considering the heterogeneity of the business sector and its internal conflicts, epitomized in (but by no means reduced to) the clashes between the group of industrialists (or the “new industrialists” as defined by Mosk [1950:18]) coalescing around state-supported CANACINTRA and other members of CONCAMIN, as well as the older firms from the north of the country which did not belong to the state-sanctioned business organisations and that were more sceptical of protectionism –partly because they relied on imported inputs, but also because of links with US subsidiaries. As a matter of fact, all the voluntary business organisations –particularly COPARMEX- would be open critics of protectionism, accusing CANACINTRA members of profiting from artificially high prices.

Izquierdo (1976) provides an overview of this tension, starting noting that it was being fuelled by the very own government's agencies' buys: “(...) government bodies and agencies are so attracted to foreign suppliers as private entrepreneurs are; lower prices, proven reliability and the predictability in delivery time allow these bodies to claim that scarce financial resources are being spent in the most efficient way when buying from US suppliers” (Izquierdo, 1976:256). Despite changes on government

regulations that re-oriented demand towards local suppliers, the private sector's perception and preferences were hardly changed.

Regarding the aforementioned business organizations, Izquierdo found a few but illustrative official statements that make the tensions evident; the "new group" of industrialists, while backing high tariffs, declared: "Those in Mexico supporting free trade are seeking unlimited benefits through imports and speculation, regardless of the effects such actions can have upon the domestic industry. Generally they represent groups that do not care about or have contrary interests to Mexican industrialisation" (from CANACINTRA 1945 1st Meeting memories, quoted by Izquierdo, 1976:261). By contrast, the CONCAMIN hinted that those being part of CANACINTRA were profiting from trade protection: "Import restrictions shall not be used for benefiting a few firms while damaging those established, important companies. "If these considerations are not taken into account, protectionist measures will hinder industrialisation rather than facilitate it" (fourth CONCAMIN Annual Meeting, quoted by Izquierdo, 1976:263).

It is clear that CONCAMIN was accusing CANACINTRA of rent-seeking; although Izquierdo himself does not go further on this topic, other researchers' findings coincide with this perspective in general terms, as exposed by Bueno (1976) and Vazquez Tercero (1966).

Neither of these scholars provides evidence in order to have a more detailed picture of the licensing; not a single figure besides King's mention of 3,000 applications a week, nor they even speculate on the question of who benefitted the most from the import licenses. Furthermore, did the government eventually "retaliate", at least by liberating the oldest items in the list?

2.4 THE RENT-SEEKING LITERATURE.

2.4.1 Introduction

By the early sixties, the theoretical framework upon which anti-trust policy was backed would suggest that US Department of Justice's attacks on monopolies and oligopolies were somewhat unjustified. Based on the "Harberger triangles" (see below) that measure the welfare costs of monopolies, these looked rather insignificant, roughly between 1 and 2 percent of GDP in the US (Harberger, 1959). Gordon Tullock was the first one to advance the idea that the overall costs were in fact much higher, since all the resources invested in actually realizing the transfer from customers to producer should be factored in. This simple claim can be thought of as the common thread on the neo-classic/institutionalist literature on rent-seeking. "They [Tullock et al.] argued that resources used to establish, maintain or eliminate trade restrictions and monopolies are part of the social cost of those policies, but had been previously been neglected." (Congleton, Hillman and Konrad, 2008:4).

In very simplistic terms, it is about rational agents that see and seize opportunities for wealth predation, instead of wealth creation, which government policies can, inadvertently at best, facilitate: "The modern rent-seeking literature describes the rational decision to invest in contesting pre-existing wealth or income, rather than undertaking productive activity" (ibid)

Different streams in the neo-classical literature developed during the seventies and especially the eighties; broadly speaking, it is possible to identify at least four categories: i) first, the theoretical developments involving mathematical models, with a strong emphasis in game-theory approaches, ii) the Regulation and Protection stream –Stigler (1971) et al., also known as the Theory of Economic Regulation, iii) the economic development and growth stream –Krueger (1974), who actually coined the term- and Murphy et. Al (1991) - and iv) the "political and legal institutions" stream –mostly, McChesney (1997) and the Rent extraction and rent creation approach".

It should be noted that a central theme in all of them is the capacity of the state to create scarcities (through policies that create rights: licenses, quotas, permits,

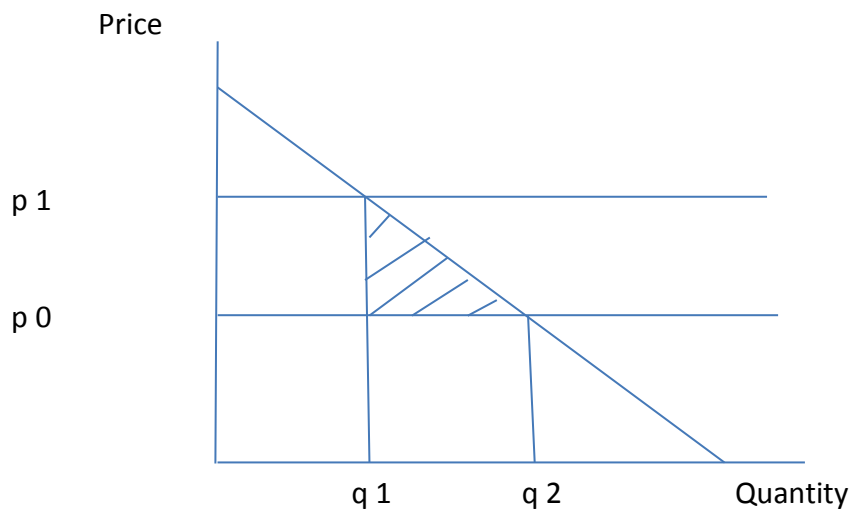
approvals and so on and so forth) which in turn mean potential rents so they attract rent-seeking. At a minimum, whether such policies in themselves are reasonable (or effective) is treated as an entirely different matter, although many authors are explicitly concerned with, and adhere to a view of a direct relationship between the size of the state and the scale of rent-seeking. However, the literature on late industrialisation in Asia has shown that rents are not necessarily always bad, triggering an intense debate and, ultimately, an alternative –heterodox- theoretical framework for understanding rents.

For instance, Khan and Jomo (2000) depart from the neoclassical insistence that all regulation, and therefore rents, is always and everywhere bad. While analysing East-Asian development in general and their successful transition to a more export-oriented economies in particular, they show that, provided some conditions, rents can act as a powerful incentive to industrial transformation –“growth-enhancing rents”-. Therefore, such alternative perspective is also taken into account.

2.4.2 Theoretical Foundations

Tullock’s point of departure is Harberger’s triangle: a tariff (or, for that, matter, a monopoly) will raise prices from p_0 to p_1 . Such increase is a net transfer from some members of the community (consumers) to others (producers). However, being both part of the same society, the welfare costs are simply the value of the shaded triangle.

DIAGRAM ONE –



Tullock starts remarking that there are some very obvious costs that are being ignored, since “collection of a tariff involves expenditure on customs inspectors, etc. (...) furthermore, customs brokers are normally hired by the shipper to expedite the movement of goods. Normally we pay little attention to collection costs because they are small, but in this case they may well be larger than the welfare triangle which is also small.” (Tullock, 1967:225)

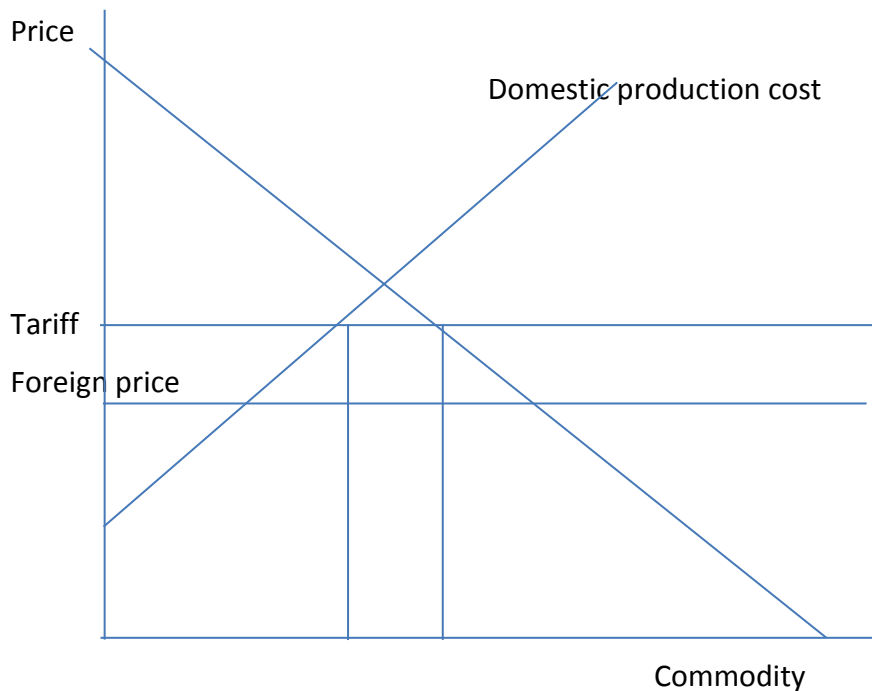
If adding collection costs would not be enough, he analyses the same diagram as if it were a tax applied to a given good. Now, if we suppose that such revenue is wasted in meaningless projects (not even stolen) then the social costs are the welfare triangle plus the total tax revenue. “The whole economy is poorer not just by the triangle, but by the whole amount of wasted resources”. (Ibid, 226)

In the case of tariffs, it should be pointed out, higher domestic prices paid by consumers are not a loss to the economy as a whole but a transfer payment; however, such producers “receive no more than they would have received had the tariff never be introduced and they had been employed in other industries.” (Ibid) In other words, the final cost of the tariff will be the triangle *plus* the difference between production costs in the country vis-à-vis international prices.

When incorporating the domestic production cost into the diagram (the supply line), that is assuming some domestic production before the imposition of a tariff, the impact of it would be a substitution effect: imports will shrink but local production

will obviously fill the gap. That way, the social cost of the tariff doubles up: it is the original triangle plus the waste of resources in inefficient production (the left triangle).

DIAGRAM TWO



Tullock notes that the trapezoid between the two triangles appears to be a pure transfer -and that is indeed the way it had been treated by economists- however, “looking at the matter dynamically”, the social cost turns out to be far larger: protective tariffs are not, generally, imposed by the government on their own, so resources are spent on lobbying (at best, if not on outright corruption) by potential winners/losers. In other words, beneficiaries of the tariff will spend on it until the marginal return on it equals the expected return from the protectionist. By the same token, those potentially affected by the tariff will also spend resources in order to influence the policy. Such expenditures are wasteful from the society’s point of view: they are not directed to increasing wealth, only to “transfer or resist transfer” of wealth: *“the problem with income transfers is not that they directly inflict welfare losses, but that they lead people to employ resources in attempting to obtain or prevent such transfers”* (ibid) (italics added)

Conceptually, the same logic applies to theft and, most importantly, to monopolies: theft -just as monopoly- is a pure transfer with no welfare cost to society (that is, it implies no reduction to national product) but the total social cost is the sum “of the efforts invested in the activity of theft, private protection against theft, and the public investment in police protection” (Ibid: 231). The real costs of monopolistic activities should be understood along the same reasoning:

“To return to Figure 1 [diagram one, above], the rectangle to the left of the welfare triangle is the income transfer that a successful monopolist can extort from the customers. Surely we should expect that with a prize of this size dangling before our eyes, potential monopolists would be willing to invest large resources in the activity of monopolizing. In fact the investment that could be profitable made in forming a monopoly would be larger than this rectangle, since it represents merely income transfer”.(Tullock, 1967:231)

However, not only successful but also unsuccessful attempts should be factored in: from those outside the monopoly, -who will spend on it until the marginal cost equals the expected return- as well as from those within: holders of such source of transfers will be willing to spend considerable sums into defending it. In turn, successful monopolies –or protective tariffs- will only invite, and effectively divert, yet more resources toward capturing such transfers. That is, in addition to the size of the transfer, the *likelihood* of securing it also matters; that is why Tullock remarks that “An efficient police force reduces the resources put into the activity of theft, and free trade or an active antitrust policy will reduce the resources invested in lobbying or attempting to organize monopolies.” (Ibid:232).

In sum, it is clear that “investing” in monopolisation –and defence against monopolisation- will not only be a function of the expected transfer, it will also be socially wasteful to the extent that not only money but human resources at large (“skilled management”) are involved. It is evident that, even though Tullock is not labelling such transfer as “rent”, and the effort and investment to secure it as “rent-seeking”, the foundational theoretical framework had been established.

Closely related to Tullock, Buchanan also set the theoretical foundations of the rent-seeking literature in mainstream economics. In his paper *Rent Seeking and Profit*

Seeking (1980) he spells the working definitions that are now standard in the neo-classical literature.

Buchanan starts clarifying the meaning of rent, given the potential confusion with its everyday usage (that of income from property) so he provides what became a standard definition: "Rent is that part of the payment to an owner of resources over and above that which those resources could command an alternative use. Rent is receipt in excess of opportunity cost." (Buchanan et al, 1980:3)

The emphasis of such definition is on the allocative inefficiency it creates: in the classic example of a monopoly, the producer *would have* still produced the same output –under different conditions. Therefore, rents indicate wastefulness precisely because they are not required to attract resources to a particular employment. However, Buchanan reckons that such definition is still ambiguous; after all, it is precisely the prospect of rents that triggers the entrepreneurial process. In other words: isn't rent-seeking another way of referring to profit-seeking?

Buchanan states that, strictly speaking, such is the case. What distinguishes one from the other is not, according to him, the behaviour of individual, and rational, decision makers but rather the ultimate outcome for the society at large (unlike rent seeking, profit seeking does have socially beneficial consequences), which in turn stems from different institutional settings: "The unintended results of individual efforts at maximizing returns on opportunities may be 'bad' rather than 'good'. The term rent-seeking is designed to describe behaviour in institutional settings where individual efforts to maximize value generate social waste rather than social surplus." (Ibid: 4)

Surprisingly³, he assumes the good institutions to be the norm: "As institutions have moved away from ordered markets toward the near chaos of direct political allocation, rent-seeking has emerged as a significant social phenomenon." (Ibid)

Anyhow, there are two salient features of the profit seeking dynamics; first, the rent dissipation process and, second, the fact that economic rents can be negative.

The dissipation process –inherent in the virtuous profit seeking- is absolutely essential for the well-functioning of markets: it means that rents do attract entrepreneurs, but *as long as* others can challenge the leader with more innovations,

³ Many economic historians would argue that it was the other way around: the few countries that got rich in the first place were the ones with the capacity to build "ordered market"-oriented institutions.

rents will eventually be brought down. Conceptually, the dissipation of rents has therefore two different components: the *time* horizon (no one accrues rents forever) and the *nature* of the rent. To illustrate this, the case of technological innovation –or any innovation, for that matter- is a case in point. The entrepreneur becomes a pure monopolist by introducing a novel product. However, the rent accruing to him “reflects the *creation* of value added in the economy rather than the *diversion* of value that already exists” (Ibid: 7) Rent creation, through entrepreneurship, is functionally quite different from rent-seeking.

However, for dissipation to take place, freedom of entry is absolutely crucial: if other entrepreneurs can sell the same product or a close substitute, the leader will see his rents being eroded, with consumers benefiting from it. As long as there are no barriers to entry, the rents will be temporary, but the process will generate innovation and economic growth, clearly socially beneficial –yet unintended-consequences of profit seeking.

The assumption of no barriers to entry is precisely broken when profit-seeking becomes rent-seeking: instead of innovating or out-competing, the entrepreneur manages to block entry through a government-sanctioned monopoly (evidently, the best way of securing one). Just as Tullock does, Buchanan emphasises the fact that the socially harmful consequences stem not only from sustained rents but mostly from potential entrants engaging in *seeking* such rents for themselves: “(...) motivated by rent but leading to socially undesirable consequences” (ibid: 8). The whole continuum this *seeking* can take place in is large: from flattery, persuasion and cajolery as in the royal courts, to lobbying, bribery and even blackmail in a more modern economy. And, again: for one successful rent seeker, all the resources spent by the unsuccessful ones should be taken into account.

As the government expands its scope of activities, the less likely rents will be dissipated: “governmental licenses, quotas, permits, authorizations, approvals, franchise assignments –each of these closely related terms implies arbitrary and/or artificial scarcity created by the government” (ibid: 9) it follows, then, that rent-seeking activity is a function of the size of the public sector –and, evidently, that import licenses are a natural candidate for rents: they artificially lower or block altogether the supply of foreign goods.

This process is reinforced in a context where political allocation of resources is privileged over the market allocation; thus, scarcities are not eliminated –let alone reduced- and “In politics, rent seeking, at best, replaces one set of rent seekers with another” (Ibid: 11).

To illustrate his point, Buchanan gives the example of a local government that sets up a licensing scheme for taxi-cabs, effectively limiting the number of them in circulation. Regardless of the effects on the particular market/industry, what matters is that rent-seeking can take place in three different forms. First of all, if the licenses are allocated by the bureaucratic authority, potential holders will try to gain the officials’ favours, either by direct means such as bribing or by trading it for promises of value for the bureaucrats. The local government, aware of this problem, might decide to auction the licenses among bidders, in which case rent seeking (of this first type) won’t take place. However, this seemingly desirable rule only makes positions within the government more attractive: it will set a competition for the access to the receipts of the auction. The diversion of resources at large is far more serious: not only because –in the short term- bribes will be larger but also –in the long run- because people will start investing less in education and more into securing a place within the bureaucracy. Now, even if the government can ensure that there will be no personal rewards, and that therefore the resources collected from the auction will be given back to society, rent seeking of a third kind may take place: specific groups (even within the government) pressing hard to have a share of such resources, either through a convenient criterion or plain transfer. Of course, “resources may be wasted at all three levels simultaneously”. The bottom line, as it is now evident, is the capacity of governments to alter the ways in which wealth is created in the first place, and how it is transferred. That’s why the following is an all-encompassing Buchanan’s definition of rent seeking: “*The resource-wasting activities of individuals in seeking transfers of wealth through the aegis of the state*” (Buchanan, Tollison, and Tullock, 1980:9)

As a final point, it should be noted that Buchanan’s approach, obvious as it might sound today, had the relevance and pertinence of shifting the attention away from the strictly “competitive market process” and toward the interactions with non-

market elements in general and institutions in particular. The ramifications of this simple idea have proven to be vast.

2.4.2 Stigler and the Theory of Economic Regulation (TER)

Albeit Stigler does not explicitly frame regulation within a rent-seeking model, there is substantial overlap with it since rents constitute the (expected) outcome of the regulatory process; in his seminal paper *The theory of Economic Regulation* (1971) he proposes what was then a novel approach to regulation: that of an *exchange*, by which there are *benefits* the state can provide to industries (as opposed to mere constraints, as it was thought) at some particular *costs*. In that sense, Stigler asks i) who will receive benefits/burdens of regulation, ii) what form regulation will take and iii) what the effects of regulation upon the allocation of resources will be. The often-quoted opening paragraph deserves full citation:

“The state –the machinery and power of the state- is a potential resource or threat to every industry in the society. With its power to prohibit or compel, to take or give money, the state can and does selectively help or hurt a vast number of industries... The central tasks of the theory of economic regulation are to explain who will receive the benefits or burdens of regulation... Regulation may be actively sought by an industry, or it may be thrust upon it. A central thesis of this paper is that, as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit. There are regulations whose net effects upon the regulated industry are undeniably onerous; a simple example is the differentially heavy taxation of the industry’s product (whiskey, playing cards). These onerous regulations, however, are exceptional” (Stigler 1971:3)

The reason why the state is such a potential resource is straightforward: the power to coerce, upon which it virtually enjoys a monopoly. Such resource –and with it, its capacity to affect profitability- means that for many industries, particular benefits are available *only through politics*, or at least available at a lower cost. This can be exemplified by the advantages that regulation (legal barriers to entry) can provide over private agreements, most notably price-fixing agreements. These are difficult to maintain not only because there’s no way of ensuring that no one will cheat but also because keeping potential participants away from the market is, at best, extremely costly. Hence, it is far more attractive to get the state to legally block entry.

Stigler illustrates this point with the observation that often (in the US) industries prefer regulation rather than direct subsidies. And that leads him to identify four core policies through which the state can benefit industries.

First of all, there is a direct subsidy of money such as the one given to the airlines throughout the sixties (the “air mail” subsidies), the merchant marine during WWII and the federal funds granted to the private education industry. As common as it can be, however, subsidies have a major disadvantage: “unless the list of beneficiaries can be limited by an acceptable device, whatever amount of subsidies the industry can obtain will be dissipated among a growing number of rivals”(Stigler 1971: 5)

Second set of policies is control over entry by new rivals. There are, of course, countless cases of state-sanctioned oligopolies, and the extent of their success in generating rents clearly dwarfs the direct subsidy. The relevance of this second device leads Stigler to state one of his general hypotheses: “every industry or occupation that has enough political power to utilize the state will seek to control entry. In addition, the regulatory policy will often be so fashioned as to retard the rate of growth of new firms.” (Stigler, 1971:6)

Evidently, tariffs and other trade-control instruments –such as the import licenses- fall under this category, and it follows that the industries in question will also seek domestic entry control. On this, Stigler does not elaborate further but notes that industries that are resource-specific –such as the oil industry- will be less likely than those that aren’t. The implication, in the context of ISI in Mexico, is straightforward since most, though not all, of the firms seeking protection were in manufacturing industries, by definition not resource-specific.

The third category is somewhat wider: it is about policies affecting substitutes and complements; however, there are substantial overlaps with the other two. The last category of policies is another extensively used: –even more so in developing economies- price control. Industries with both large fragmentation and highly elastic demand will be far more prone to seek this policy.

Stigler also notes that the interaction between supply and demand of regulation, mediated by the political process, imposes three some limitations upon the cartel policies pursued by any given industry. First, the distribution of control in the industry amongst firms changes: under regulation (say, quotas) small firms benefit relatively

more than large ones -i.e., more than proportional to their share of industry output and therefore to their capacity to influence prices. Also, procedural safeguards required by law are costly; moreover, the political process admits powerful outsiders to the industry's council.

In order to illustrate the correspondence between regulation and economic interests in general, and some of the mechanisms displayed in particular, Stigler describes the motor industry development in the thirties in US; basic statistical analysis shows that a clear correlation between the expansion of motor transportation –largely thanks to improved roads- and new regulations restricting the quantity of merchandise that could be taken by motor trucks, as a result of intense lobbying by the railroad industry, which was experiencing serious competition, particularly in the market of short and medium-haul (Stigler, 1971: 10). Evidently, the railroad industry took advantage of not only the already-established political connections but also of the fact that the motor industry, having far more firms, wasn't as organised.

To summarise, Stigler makes a case of regulation as being subject to supply and demand dynamics (as opposed to the “normative” approaches to regulation) whose outcome is **rent creation**: “The idealistic view of public regulation is deeply imbedded in professional economic thought. (...) Until the basic logic of political life is developed, reformers will be ill-equipped to use the state for their reforms, and victims of the pervasive use of the state's support of special groups will be helpless to protect themselves” (Stigler, 1971:13). It should be noted that this *quid pro quo* to politicians is equated to votes, an approach that became deeply imbedded itself with Stigler and thereafter.

As part of the theory of economic regulation, Peltzman (1976; 1989) widens the analysis in order to frame the exchange of regulation for not only votes –which is too narrow- but other “valuable resources” that can be of interest to politicians at large:

“Regulatory decisions can also elicit campaign contributions, contributions of time to get-out-the-vote, occasional bribes, or well-paid jobs in the political afterlife. Because the more well-financed and well-staffed tend to be more successful and because a self-interested politician also values wealth, he pays attention to these resource (money) consequences. Accordingly, groups that might, themselves be too small to offer many votes directly in support of a

regulatory policy can nevertheless affect that policy by delivering other valuable resources.” (Peltzman, 1976:7)

This is particularly relevant in contexts where votes may not be the most valuable asset to politicians, both in democratic regimes and perhaps even more importantly under incipient democratic regimes such as the PRI in Mexico. Bribes and jobs in the political afterlife would have been far more attractive than votes –controlled anyway by the party local bosses.

Anyhow, the early economic theory of regulation –its core element being an exchange model of rent creation- was criticised on at least two fronts, resulting in a more refined theory and in significant advancements such as McChesney (1989; 1997). First, some authors, such as Richard Posner (1974) noted that numerous pieces of regulation did not benefit producers *at the expense of* consumers and that there are only a few industries that fully operate as price-setters. Second, the politician appears as a mere “faceless broker” surrounded by private demands, rather than having his own initiative. In response to the first caveat, the “cost-predation”/“Raising rivals’ costs” model was proposed; the second gave rise to the “Rent extraction” approach advanced by McChesney (1997), presented here in the next sub-section (political and legal institutions).

The “Rising rivals’ costs” model -still one of *rent creation*- focuses on “infra-marginal” rents: those created not primarily at the expense of consumers but at the expense of other firms *within* the industry; that is, regulation that will increase costs for all firms, but proportionately more for marginal firms, thus benefiting a particular sub-group even if prices are not increased (which in reality is unlikely). For instance, big, capital-intensive firms will lobby for regulation in the labour market that raises its price so as to impose higher costs to labour-intensive firms.

In other words: “Industry cooperation to obtain rents for all firms is replaced by rivalry among industry subgroups to benefit some firms at others’ expense” (McChesney, 1997:16). Conceptually, the implication for the analysis of import licenses is as follows: under a system of discretionally allocated quotas/quantitative controls, firms not getting the permits for imported inputs (the majority) will see their costs rise substantially, while those that did get the licenses will see them

decrease, in a context of high prices. That is to say, import licensing can be a highly effective “rising rivals’ costs” device: protection raises the price of a previously imported input for all the industry, but those few, connected firms will have privileged access to cheaper imports. Therefore, provided such firms are certain about their connections, they will actively support protectionism.

2.4.4 Political and legal institutions

Building upon the economic theory of regulation, McChesney notes three core deficiencies of this conventional framework. First, he insists that “the government” is not an abstract entity but rather a heterogeneous group of politicians/bureaucrats facing diverse preferences and constraints. McChesney warns about the tautological nature of the perspective on the politician as a rational, maximizing individual: (...) “saying just that the politician does what he does because he wants to do it” (McChesney, 1997:17) More specifically, in the “market for regulation”, rather than being a mere “faceless brokers” politicians/bureaucrats can and do have their own initiative and making their own demands: they know there are diverse ways in which it is possible to benefit from rent creation. Furthermore –the second point- there is no consideration of ways other than rent creation by which bureaucrats can benefit from private individuals. Third, no consideration is given to the possibility of politicians benefiting from imposing net losses.

Therefore, McChesney shifts the attention from firms and rent creation toward politicians/bureaucrats and rent extraction. In a nutshell, it is the “political strategy of cost forbearance”: in addition to, or instead of trading regulation for votes, bribes or other resources, officials can threaten to impose costs (plainly, political extortion/blackmail) and then refrain from doing so. Of course, the threat must be credible and the expected cost of the impending action must be higher than the value of what private parties have to give up to avoid it.

McChesney notes that “the political strategy of cost forbearance can assume several forms” (Ibid:23) which is evident from the diversity regulation and government policy can have. The most obvious, however, would be “the threat to deregulate an

industry previously cartelised” because the stakes (rents being earned) are usually high, thus implying a high asking price.

Within the specific case of legislation, there are two core methods to extract rents: legislative threats to reduce prices and legislative threats to raise costs. For the former, price controls are an obvious choice but not the only one: revocation of charts, permits or licenses –thus destroying some sort of monopoly- also fall within. The latter is also straightforward: threats to impose taxes are also effective. On this point, McChesney presents evidence of the US state legislation process: the “*milker bills*”, as a politician himself explains:

“Early on my association with the California legislature, I came across the concept of “*milker bills*” –proposed legislation which had nothing to do with milk and much to do with money, the mother’s milk of politics”... Representative Sam, in need of campaign contributions, has a bill introduced which excites some constituency to urge Sam to work hard for its defeat (easily achieved), pouring funds into his campaign coffers and “forever” endearing Sam to his constituency for his effectiveness” (Stubblebine, 1985:2; quoted in McChesney, 1997:30)

The evidence is ample, to the extent that the 1972 re-election campaign for Nixon included Republican congressmen covertly threatening business leaders: “give us more, or we may do something rash” (Jackson, 1985a; quoted by McChesney, 1997:32) Needless to say, the number of deals that are unknown is higher.

Just as rent creation entails costs to society far higher than the deadweight loss, rent extraction implies losses far higher than the actual value of the transfer. McChesney identifies at least four: i) the disincentive to create new capital that may be subject to expropriation or extortion, ii) the fact that “the value of existing capital is also diminished by the possibility that it will be extracted” (ibid: 34); iii) the transaction costs incurred in the process: not only there is a socially positive opportunity cost to bureaucrats’ time, but all the resources invested in making the threat possible (time, money and expertise) must be accounted for; iv) finally, the deadweight costs of hiding resources in order to avoid extraction.

Albeit McChesney's focus is the US, he explicitly states that both 'modern' and 'less-developed' practices are "one and the same", the difference being one of "complexity, camouflage and rhetoric". In fact, one of the most extreme cases of rent-extraction comes from Brazil under Fernando Collor de Mello: as a major, Collor sold tax relief worth \$100 million to sugar cane firms for \$20 million; as president, he created a supposedly anti-inflation programme, freezing all bank deposits over \$1,200 for 18 months. It was a "colossal failure" as a policy, but he would sell companies to unfreeze their capital for a 10 per cent commission. Investigators later uncovered \$32 million collected personally, though it is supposed to be between 10 and 30 per cent of the grand total (McChesney, 1997:68)

In sum, it is abundantly clear that rent creation is by no means the only rent-accruing mechanism: **rent extraction** can also be pervasive and, under particular circumstances easier to implement from the bureaucrats' perspective. Moreover, these two devices are far from being mutually exclusive; in fact, there is evidence that politicians use the two –adjusting the mix as circumstances change. In any case, it should be clear by now that trade policy in general and quantitative controls in particular are also subject to rent extraction dynamics: threats to tighten/liberalise commerce can be used as threats to raise costs/reduce prices; at a more basic level, extortion at the customs, albeit a "petty" form of rent extraction, can nonetheless be harmful to the economy by imposing higher transaction costs.

2.4.5 International Development and Growth

As mentioned above, the actual term of rent seeking was coined by Ann Krueger (1974) in her seminal paper *The Political Economy of the Rent-Seeking Society*. Although no formal definition is provided, the opening paragraph establishes the basic logic: government restrictions upon economic activity generate rents of different kinds, thus people compete for them. "Sometimes, such competition is perfectly legal. In other instances, rent-seeking takes other forms, such as bribery, corruption, smuggling and black markets." (Krueger, 1974:291)

Within this range, Krueger focuses on the "important case" of quantitative restrictions to international trade -import licenses. Under such trade policy, "rent

seeking i) leads the economy to its operation within the transformation curve, ii) the welfare loss is unequivocally greater than the tariff equivalent of such restrictions, and iii) if competitive, it results in a divergence between private and social costs of certain activities.” (Ibid) The core claim of the paper is that the welfare cost of import controls amount to the welfare cost of the tariff equivalent *plus the additional cost of rent-seeking activities*. In other words, Krueger takes a step further: not only assessing quantitative controls in terms of the next-best alternative of tariffs and of well-known costs such as time, red tape, etc. but the actual resources spent in order to *compete* for those licenses.

The starting point of the analysis is rather clear: “*when quantitative restrictions are imposed upon and effectively constrain imports, an import license is a valuable commodity*” (Krueger, 1974:291; italics added) thus, it follows that resources will be devoted to competing for those licenses, up to the value of the rent.

The competition can take place within three different mechanisms. In the first case, import licenses are allocated in proportion to firms’ capacity, resulting in entrepreneurs investing in extra capacity to get the licenses. This can lead to excess capacity, as long as the costs of expanding are lower than the expected return of the rents. The second mechanism involves allocating import-licenses in a pro rata basis, in proportion to the applications from importers-wholesalers; the result is often a larger-than-optimal number of firms. Finally, a non-systematic mechanism whereby government officials decide on license allocation means that competition will occur through the already mentioned mechanisms:

“But, in addition, competition can also occur through allocating resources to influencing the probability, or expected size, of license allocations. Some means of influencing the expected allocation--trips to the capital city, locating the firm in the capital, and so on are straightforward. Others, including bribery, hiring relatives of officials or employing the officials themselves upon retirement, are less so. In the former case, competition occurs through choice of location, expenditure of resources upon travel, and so on. In the latter case, government officials themselves receive part of the rents”(Krueger, 1974:292).

Clearly, the latter implies the same sort of rent creation through *exchange* described by the theory of economic regulation; Krueger also notes that there is a variety of valuable resources and, moreover, that a supply side for rents means a distortion of

the human capital formation given the relatively higher returns for government officials vis-à-vis other occupations.

On the empirical side, Krueger offers rough estimates of the value of rents for India and Turkey; they reflect that the value of import licenses to the importers-wholesalers was sizable. With data about 10 per cent of Turkey's imports, Krueger estimates the c.i.f. value of imports in the sample at Turkish Lire (TL) 547 million, the landed cost of them at TL 1,443 million and finally the value at the wholesale level at TL 3,568. Assuming a 50 percent markup attributed to "normal" costs incurred by the wholesalers (storage, transport and the like) she concludes that the value of import licenses was TL 1,404 million, or three times the c.i.f. value of imports. Overall, the estimate she offers for rents stemming from import licensing as percentage of GNP is 15 per cent for Turkey (in 1968 only), while 7.3 per cent in India in 1964 (Krueger, 1974:294). Clearly, the value of import licenses was sizeable.

Krueger also analyses the theoretical consequences of import licensing, modelling an economy with two commodities, food and consumption goods, the latter being imported. Through distribution, food is bought from the agricultural sector to be exported, and the earnings are used to buy imports that are sold in the domestic market. The model allows for three solutions: free market, import restrictions without rent seeking (tariffs only) and import restrictions with rent seeking (quantitative controls). As expected, the first two are better solutions than the third one in that the earnings from food and imports are maximized; interestingly, however, even a total import prohibition would be preferable to the licensing system (assuming there's competition for them) because such action would release resources from rent-seeking and because the excess domestic prices might even be lower than the value of the rents under the licensing. The whole point of Krueger's model can be summarised as follows:

"The above results are sufficient to indicate that, for any given level of import restrictions, competition among rent-seekers is clearly inferior to the tariff equivalent of the restrictions, in that there could be more food consumed with no fewer imports under the latter case than the former. To the extent that rent seeking is competitive, the welfare cost of import restrictions is equal to the welfare cost of the tariff equivalent *plus the additional cost of rent-seeking activities*". (Krueger, 1974:299)

In her conclusions, Krueger highlights the political implications of rent-seeking: governments are usually caught “on the horns of a dilemma” because if they restrict entry and thus limit competition for rents, they will be showing favoritism to one group in society (that is, a lower overall cost production of rent seeking but a more unequal distribution of income). On the contrary, if it allows competition for rents there will be less favoritism –a more equal distribution of income- but the overall economic costs of rent seeking will be higher.

In a related, more empirically oriented work, Krueger (1975) analyses the mechanics of import substitution during the 50’s and 60’s in the Indian automobile-ancillary industry. Although her concern is basically the cost-benefit assessment of this process (using the foreign exchange saved or earned as the benchmark) and does not address rent-seeking issues directly, her work provides a useful parallel to Mexico’s import policies.

The rationale for ISI in India was both the state’s determination to industrialise the country and a severe shortage of foreign exchange during the 50’s; the real challenge was to find the best means of achieving this. The government decided that priority should be given to imports of goods “essential” to the development of domestic productive capacity. At the same time, it was established that imports of goods competing with domestic industries should be limited in order to “conserve scarce foreign exchange” and to provide incentives for domestic production of those items. The strategy rested upon three core policy tools: industrial licensing, import licensing and price controls. From the point of view of the indigenous content of locally produced goods, the strategy was successful: the mean ratio of imports to supply was .64 in 1950-51, .35 in 1960-61 and .15 in 1969-70 (Krueger 1975:19) By 1970 most of India’s imports were intermediate goods and raw materials, after successfully replacing capital goods imports.

However, those policy tools had unintended consequences. Industrial licensing resulted in more, not less, concentration (as it was originally planned) because the larger firms applied for licenses –which were limited in number- even when they had no immediate expansion plans. That is, some industries were willingly losing efficiency but effectively preventing competition. Import licensing was carried out on the basis of whether i) the good in question was domestically available and ii) if not,

whether a domestic substitute might have not been used. This, combined with the “banned items list” (goods prohibited for importing) resulted in a “lack of competition and an absence of incentives for efficient production” (Krueger, 1975:27). That is partly why the government had to impose price controls: otherwise the strategy would have been unsustainable. Moreover, she notes that these elements combined created a re-sale market for licenses, given the savings achievable by importing goods that would otherwise have to be purchased domestically:

“The combined effects of import licensing and investment licensing give virtually every firm a monopoly or quasi-monopoly position. The entrepreneur who is more successful in getting licenses of greater value and/or in getting licenses more quickly than his fellow producers will have higher profits. The producer who does not compete successfully for licenses cannot produce at all, no matter how skilled he is in achieving engineering efficiency” (Ibid: 108)

Krueger’s case study -the automobile-ancillary industry- provides a perfect example not only of the mechanics of import substitution but also of rent-seeking that ends up hindering growth and industrialisation. After having interviewed 55 firms in this industry, and using comparisons with international prices, Krueger provides estimates for the economic cost to society of producing those goods (i.e., foreign exchange saved). The author concludes that assemblers were penalised with negative effective rates of protection (in one case it was -14 per cent). On the contrary, all of the ancillary industries enjoyed not only positive rates of effective protection but very high rates: the range was from 14% -in the chemical industry- to 642% for a metal factory. As a consequence, in both the assembly and the ancillary industry there were cases with negative resource costs, which means that it would have been possible for the country to “have as much of each vehicle and component as was actually consumed, with a net improvement in her trade balance of almost \$20 million, if a 50 per cent cut-off rule had been used and a share of the output of the low cost producers exported” (Ibid: 97). Furthermore, there was a correlation between relative inefficiency (i.e., those firms employing more labour and capital per unit of value added compared to other Indian firms) and profitability, a fact that obviously implies severe distortions in the economy or, in other words, profitability based on rent-seeking.

From the qualitative evidence gathered by Krueger in interviews, it is stated that i) firms had to devote substantial resources to the process of import licensing, ii) production was often lost because of delays in granting the permits and, above all, the lack of competition in the ancillary industry was imposing substantial costs to assemblers: “(...) all assembles were willing to discuss ancillary pricing. The consensus appeared to be that ancillary prices were extremely high whenever the producers had monopoly power and that little could be done about it. All assembles tried to keep two possible suppliers for every item, partly to insure that they would not find their supplies cut off and partly to reduce the bargaining power of the ancillaries” (Krueger, 1975:75)

The conclusions are straight-forward: badly managed protectionist policies, especially the licensing, entail preventing successful firms realizing their potential in world markets, given the unavoidable high prices of new sources of supplies; moreover, the same goals could have been achieved at a lesser cost to the economy.

After the Asian financial crash of 1997, Krueger stressed the link between the crisis and long-term failures of economic policy, namely a faulty baking system and “cronyism”, defined as a situation by which *“those close to the political authorities receive favours that have large economic value. Usually, these favours are not outright transfers of wealth but rather take place through the provision of economic entitlements”* (Krueger, 2002:2). In other words, crony capitalism entails, by definition, the distribution of rents well above the minimum required to induce investment. As such, cronyism can be seen as the extension of competitive (i.e., successful) rent-seeking. In a different work (2001), Krueger remakes some of these arguments and highlights that “government failures” in developing countries have usually outweighed the “market failures” that gave place to government intervention in the first place. Besides the contestability of this hypothesis –and Krueger’s anti-government agenda- she cites three broad “themes” relating “government failure” with rent-seeking that resonate with the previous theories.

Firstly, Krueger notes the incredibly high rates of effective protection (ERP) among developing countries; again, Turkey and India come to top in the list: both countries had, at some points, industries with ERP anywhere between 100% and 3,354% (Krueger, 1990:14) which means that the “infant industry” argument was much

abused and in fact states were more often than not unable to reverse the protection achieved:

“Not only was protection high, but it was conferred in ways which gave virtual monopoly power to domestic entrepreneurs. Efforts to remove this ‘temporary’ protection were infrequent and, when they did occur, met with great resistance. In effect, the decision to grant some infant industry protection had several results: it resulted in pressure groups lobbying for continuation of the protection; it reduced the future power of the technocrats to formulate economic policy and it created incentives which did not induce maximal efficiency of the enterprises.” (Ibid)

Secondly, she focuses on the question “what is the government?” and -clearly making a case against structuralism- emphasises that the assumption that the government is “omniscient, selfless” while policy-makers are “social guardians” is simply wrong. This is clearly in line with the point made by McChesney and summarised above.

Thirdly, Krueger elaborates the rent-seeking argument by describing the dynamics of government intervention: i) when economic policies create “something that is to be allocated at less than its value by any sort of government process, resources will be used in an effort to capture the rights to the items of value” (Ibid, 17); ii) whenever a government policy has clearly identifiable beneficiaries, “those groups will tend to organize in support or opposition to the policies and then lobby for increasing the value of the gains or reducing the value of the losses from those policies” (Ibid). The implications are clear: entrepreneurs will spend resources to capture property rights from the government given the opportunity to do so, diverting resources from production or innovation.

Again, Krueger is making a point against protectionism in general and import licensing in particular; the combination of a discretionary way of granting them, plus the size of the potential benefits –rents- means that even if policy-makers are well intentioned, it is easy to “capture” –even more so if government officials are badly paid, short-term oriented and the bribes are huge.

From a more explicitly institutional analysis, Murphy et al (1991) and Shleifer, Murphy and Vishny (1993) focus on the effects of rent seeking on both the allocation of talent and economic growth in general. On the first point, Murphy et al point out that rent seeking seems to have an inherent advantage over the entrepreneurial choice for talent, a situation that can get worse under poorly defined property rights:

with large markets for rent-seeking, more talent will leave innovation, which in turn will make the returns to entrepreneurship to fall farther (relative to those of rent seeking). In other words, a productivity slowdown, under pervasive rent seeking, will become self-sustaining.

Amongst the factors that are crucial to make rent seeking more attractive, they cite three core categories: markets, firms, and contracts. Large “official” rent seeking sectors –government, army and the church- in addition to substantive wealth that is up for grabs (weak property rights) certainly attract rent seeking; at the firm level, substantial authority and discretion enable people to freely collect large sums, and at the contracts’ level, the ability to keep a large portion of collected rents (Murphy Shleifer and Vishny, 1990: 25) will also raise the attractiveness of rent seeking. As a case in point, they cite France’s tax collection and India’s water rights: “Tax farmers throughout history bid fortunes for positions” (Ibid: 26)

To test their hypothesis, they run a set of regressions on the effects of enrolment in law schools (i.e., lawyers as a proxy for rent seeking) versus engineering (proxy for innovation) in 55 countries, between 1970 and 1985 and they find that an extra 10% enrolment in engineering increases growth rate by 0.5 per cent, while 10 per cent extra lawyers actually reduces growth rate by 0.3 per cent (Ibid: 29) Not surprisingly, they conclude that “Lawyers are indeed bad, and engineers good, for growth. This suggests that private incentives governing the allocation of talent across occupations might not coincide with social incentives. Some professions are socially more useful than others, even if they are not as well compensated” (Ibid: 33)

In a closely related paper, Shleifer, Murphy and Vishny (1993) refine some of these arguments and underline the connection between pervasive rent seeking and low growth, particularly through the effects upon innovation. There are two reasons for this: First, “Rent-seeking activities exhibit very natural increasing returns” (Shleifer, Murphy and Vishny, 1993:409) that is, increased rent seeking only makes itself more attractive vis-à-vis productive activity, which can lead the economy to multiple, yet undesirable, equilibria of very high returns to such activity while keeping output low. Second, “Rent-seeking in general and public rent-seeking in particular is likely to hurt more innovation than everyday production” (Ibid); the reason being a relatively higher dependence of entrepreneurs on government-supplied goods such as permits,

licenses, etc. which exposes them to bribery, extortion and even expropriation –to the extent that can hinder entrepreneurship altogether.

Shleifer et al., cite three reasons why rent seeking exhibit natural returns. First of all, a “system” subject to rent seeking usually has *fixed* costs: once a legal code has been established, lawyers can sue each other’s clients cheaply. Then, it usually is self-generating: “offense creates demand for defence” –once a company hires lawyers, potential targets of litigation will surely follow suit. Moreover, in almost all forms of rent seeking there is “strength in numbers” since the more people engaged on it, the easier and more attractive it becomes to potential entrants. This is exemplified by what happens with increased theft –the probability of being caught is inversely proportional to the number of people engaged in it.

As in their previous work, they emphasise the importance of property rights and rule of law, which determines the actual and potential “productivity of rent seeking”, which in turns affects people’s choices regarding the productive activities versus rent seeking ones. As evidence, they quote Bates (1987) who has shown how African farmers are easily driven away from the markets by successful rent seekers through all sorts of extortions. Of course, this is doubly damaging: not only disincentives farm production; it encourages more people to become rent seekers themselves.

2.5 Alternative approaches to rent-seeking: rents as growth-inducing devices

Heterodox approaches to rent-seeking stem primarily from research that openly challenged the liberal interpretation of South Korea's and Taiwan's spectacular rise: namely, the claim that it was a predominantly market-driven phenomenon. Thus, Amsden (1989) and Wade (1990) led the heterodox reinterpretation by showing that the "market-led, resource allocation" narrative was indeed misleading; in fact, government intervention had been instrumental. Other authors, particularly Rodrik (1994), Chang (1994), Akyuz and Gore (1996) Khan and Jomo (2000) substantially expanded and enhanced the heterodox analysis of East Asia. Of particular relevance for this research are Chang (1994), Akyuz and Gore (1996) and Khan and Jomo (2000) since they provide evidence that rent creation was at the core of the industrial take-off; Khan and Jomo analyse those conditions under which rents can be growth-inducing, and by extending their analysis beyond South Korea and Taiwan they develop a robust theoretical framework that directly challenges the liberal rent-seeking literature: rents are not always necessarily bad, and under particular circumstances they can be powerful devices to induce economic development –by rising investment and overcoming market failures at large.

It must be acknowledged that even if all these authors agree on the instrumental nature of government action, not all of them agree on which specific interventions mattered *the most*: some analyse those government policies aimed at positively discriminating between industries (Amsden [1989] and Wade [1990]) while others (Akyuz and Gore [1996], Chang [1994]) focus on policies that effectively raised capital accumulation, thus establishing a link between measures that altered the relationship between profits and investment.

Amsden (1989) first highlighted the fact that these countries overcome the penalties of 'late industrialisation' with a high degree of state intervention, by identifying mechanisms that would make industrial diversification feasible. Core to this process was its reciprocity: subsidies and other benefits in exchange for higher output of exports and substitution of imports; in other words, "the state in late industrialization has set relative prices deliberately 'wrong' in order to create profitable investment opportunities". (Amsen, 1989:13) Specifically, high profitability is identified as key,

although it is not analysed in detail.

Closely related, Wade (1990) shown that numerous and diverse industrial-policy instruments were used in order to bring investment decisions in line with the government's agenda. This brings into light the importance of political and institutional underpinnings of industrial policy. The core of his argument, known as 'governing the market', does indeed replace resource allocation with capital accumulation as the crucial process to understand East Asia's take-off:

The political economy approach treats capital accumulation as the principal general force for economic growth. It interprets East Asian success as the result of a higher level and different composition of investment than in less successful countries. The difference in investment is due, in important if difficult to quantify part, to government actions to constrain and accelerate the competitive process. These actions were carried out by a relatively authoritarian and corporatist state. We called this the governed market theory" (Wade, 1990:297)

The argument on the centrality of capital accumulation was followed and carried further by Akyuz and Gore (1996) who pointed out the need to successfully explain the rapid rise in savings –which in turn explain the rapid rise in investment. They showed that the growth in corporate profits –along other profit-related income- was directly linked with capital accumulation; high profits "increased simultaneously the incentive of firms to invest and their capacity to finance new investment" (Akyuz and Gore, 1996:464). Pointedly, they contrast this virtuous 'investment-profit' nexus in Asia with the "Latin American phenomenon of profits without investment" (Ibid).

These authors reckoned there are intrinsic reasons accounting for the high corporate savings and profits (above all, the structure of shareholding and ownership which is dominated by business groups/families, thus allowing the firm to concentrate on the long run) although there is wide consensus that government policies had a much powerful effect upon profitability. On the one side, fiscal policies played a role –tax breaks, special depreciation schemes, etc.- while on the other, trade, financial and competition policies were vital: 'state-created rents' far outweighed fiscal incentives as investment-inducing devices by compensating for the high risks of new enterprises. "In East Asia rents were created through a mix of selective protection,

controls over interest rates and credit allocation, and managed competition including the encouragement of mergers, the co-ordination of capacity expansion, restrictions on entry into specific industries, screening of technology acquisition, and the promotion of cartels for specific purposes such as product standardization (...) as a result, prices were allowed to deviate from international ones” (Akyuz and Gore, 1996:467).

Regarding protectionist measures in general and import licenses in particular, it is essential to highlight another stark contrast with Latin America: rents from trade-control measures –selling at a premium in the domestic market- were in fact linked to export performance (Korea) and, in Taiwan’s case, the very allocation of import licenses was conditioned to export performance. Quoting Wade (1990:129), they remark that “those who get the windfalls (‘rent’) from importing scarce commodities are at the same time contributing to the economic success of the country by exporting” (Ibid:467). An earlier example of this –Akyuz and Gore note- is to be found in Japan during the early fifties: the government would allow trading companies to sell Cuban sugar at 2 to 10 the import price only if they used a portion of the profits to subsidise ship exports.

The fundamental link between the creation of rents and capital accumulation in East Asian countries is backed with five crucial factual claims: first, these governments allowed rents almost exclusively in those activities that were aligned with national interests, and the overall performance of an industry was always more important than the interests of a single firm; second, rent-seeking was kept under tolerable levels, which is partly related to the third point: limits were imposed upon nonproductive channels of wealth creation such as real estate speculation and abuses of public office. Fourth, rents were provided “on a selective and temporary basis and withdrawn as new industries became mature enough to compete internationally” (Akyuz and Gore, 1996:468). Lastly, governments managed to maintain the realization of rents tied to performance standards.

Evidently, all these points –which were documented also by Chang, Wade and others- contradict directly the theory of rent-seeking. By doing so, these authors shift the debate toward the question of how did governments achieve this optimal outcome. In other words, in the context of late-industrialisers, it becomes a question of which

conditions have to be met for rents to be growth-enhancing. Mustaq Khan and Jomo (2000) provide a detailed answer.

In *Rents, Rent-seeking and economic development –Theory and evidence in Asia* (Khan and Jomo, 2000) the authors provide a broader theoretical framework for analysing rent-seeking. The starting point, on a conceptual basis, is Tullock's basic proposition: the overall costs of seeking monopoly rents are much larger than the –relatively- small deadweight welfare loss implied with monopoly rents. However, Khan departs from the neo-classical analysis of rent-seeking in a number of ways: i) to start with, he broadens the definition of rents, thus including different types and emphasising rent-seeking as a process with *inputs and outcomes* ii) in contrast to Krueger's model, the input-cost of rent-seeking can be lower or higher than the value of the rent, depending on the nature of the expenditure and the institutional rules in place; iii) it follows that some rents are value-reducing while others –under certain circumstances- can be value-enhancing, for instance when generating innovation or when inducing better monitoring; iv) the final outcome of rent-seeking not only depends on the specific type of the rent but also on political variables: the distribution of power among different agents and groups is determinant.

Thus, Khan argues –in line with Akyuz and Gore- that the East Asian industrializers' success was based not on unusually low levels of rent-seeking but on the creation of value-enhancing rents and the ability of the state to monitor and enforce performance-related agreements with the private sector (Khan, 2000:77). In other words, value-enhancing rent-seeking outweighed, in the long-run, value-reducing rent-seeking. As such, Khan's analysis, avoiding overly simplistic assumptions and explicitly bringing political economy and institutional economics literature into the conceptual framework, allows for a richer and deeper interpretation of the role of rents in late-industrialisation processes.

It is worth, therefore, to describe in some detail the fundamental differences regarding the very concept of rents. Against the classical definition ('the portion of earnings in excess of the minimum amount needed to attract a worker to accept a particular job or a firm to enter a particular industry' [Milgrom and Roberts, 1992:269]) Khan and Jomo stress the difference between the minimum amount needed to attract suppliers of inputs and the payments "which may actually be

necessary to induce them to produce the good or service” (Ibid, 22). An example illustrates their point: in the steel industry, owners get a 5 per cent return and workers get \$15,000 a year, while the second-best alternative for the former is producing coal with a 4% return and earning \$14,000 for the latter elsewhere; the question is whether steel could have been produced if owners and workers were forced, by the circumstances, to accept 4% and \$14,000 respectively. If it is the case, then rents signal inefficiency, but if steel could not have been produced under this scenario, allowing them to get this “excess” income is not inefficient at all.

The distinction is subtle yet important: rents always imply excess incomes from the point of view of what the recipients would have accepted given the second-best alternative, but they “are not always excess payments in terms of what is necessary to pay them to produce the good, provide the service or carry out the activity in question” (Ibid). Khan points out that this distinction is absent in the early neo-classical analysis because the model of perfect competition does not consider any reason for which capital and labour could require special rewards in particular sectors: “new technology appeared from nowhere and did not have to be produced or learned, property rights already existed, labour could be costlessly managed, information was free and symmetric and, most important of all, conflicts over property rights did not exist and so transfers to maintain political equilibrium were not necessary” (Khan and Jomo, 2000:23). It follows naturally that not all “excess” income is always “bad” for economic growth.

Having set this crucial distinction, Khan and Jomo extend the categorisation to six different types of rents: monopoly rents, natural resource rents, rent-like transfers, Schumpeterian rents, rents for learning and rents for monitoring. The first one falls close to the conventional meaning: monopolies impose a social cost (the deadweight welfare loss) and signal allocative inefficiency; in addition, the lack of competition means no incentives for cost reduction: management will hardly make its best effort, thus creating X-inefficiency and escalating the social costs well above the DW loss. On Natural resource rents –the second kind- signal efficiency, because property rights over scarce resources mean that such resource is exploited to the point where the marginal cost, in this case of producing fish, is just equal to the marginal benefit. Rent-like incomes –the third- are transfers organized through the political system.

Taxes, subsidies and direct transfers (legal and illegal) that convert public property into private property fall within this category.

The remaining three types of rents –*Schumpeterian, learning and monitoring*- have in common that information costs or failures are implied in some way or another. The source of Schumpeterian rents is knowledge embodied in machines or technology in general which is non-reproducible in the short run, thus giving the entrepreneur an edge over his/her competitors. It may be natural (from innovation) or created by the state.

Learning rents result from the fact that “left to their own devices, developing country entrepreneurs may prefer low productivity but safer locally known technologies to high productivity but risky new ones. The latter may eventually be socially beneficial but may be financially ruinous for the entrepreneurs involved if things go wrong” (Khan and Jomo, 2000:47) Thus, one possible solution for inducing the adaptation of new technologies to local conditions is to subsidise those industries; in contrast to a mere transfer, rents for learning are conditional on the achievement of learning over a specified time frame. This is precisely the problem: the subsidy is justified as long as there is a specified time frame and the conditionality is credible, but this is easier in theory than in practice: “(...) Too long a period can also result in waste, as infants know they will never have to grow up and learning can actually slow down. Thus, as before, there is an intermediate period of protection which is optimal for each sector. Clearly, enforcing this period is more difficult. The state has to be clear about the kind of performance it expects from learners, and it has “to be able to withdraw rents if performance is poor” (Ibid, 51). This assumes a government with both technical competence and the ability to correct mistakes at an early stage and make conditionality credible. Khan contrasts the developments of South Korea, on one hand, and India and Pakistan, on the other: in the former, firms successfully adapted and learned new technologies, while in the latter it was impossible to remove rents from the “infant” industries, given the political dynamics taking place. In sum, rents differ widely in their implications (outcomes) and, crucially, political underpinnings cannot be simply ignored.

A second, simpler distinction stemming from the criteria of outcomes is also relevant: i) efficiency implications –or static, Net Social Benefit (NBS) and ii) growth

implications –or NBS over time. Thus, monopoly rents are inefficient (i) and growth reducing (ii). Natural resource rents are (i) efficient and grow-enhancing (ii); rent-like transfers are (i) neutral, with possible incentive inefficiencies and (ii) indeterminate; Schumpeterian rents are (i) likely to be efficient and (ii) likely to be growth-enhancing, while rent for learning are (i) inefficient but (ii) may be growth-enhancing (provided the conditionality assumption holds).

The next step in the analysis is *rent-seeking* as such, defined as “the expenditure of resources and effort in creating, maintaining or transferring rents” (Ibid: 70) Of course, these expenditures can be legal –lobbying, contribution to political parties, etc.- of illegal –bribes and so on. Khan agrees with the conventional analysis of rent-seeking (the costs of seeking and maintaining a monopoly are much higher than the DW losses) but departs from it in a number of ways: i) rent-seeking not only creates monopoly rents: other types of economic entitlements may well be created; ii) rent-seeking is a process with inputs and outputs: conventional analysis focuses on the social costs of the resources used up in rent-seeking but does not address the question of the product of the activity: *different rents produce different outcomes*.

Focusing on the inputs (lobbying, bribing, political activity and so on) and the outcomes (the creation, maintenance, transference and destruction of economic rights) it follows that assessing the net effect of rent-seeking in the society as a whole would imply subtracting the costs of inputs from the net social cost or benefit associated with the rents created –a substantially more realistic approach than the neo-classical theory.

At a more empirical level, it also means asking *who sought what rent and how*. This not only addresses the variety of possible rent-outcomes and the diversity of ways (inputs) to get those rents, but explicitly acknowledges the issue of distribution of power: the ability to oppose change with credible threats matters.

Furthermore, there are three different rent-seeking scenarios: in the first (scenario A), individuals seek rents through private negotiations in which the state plays no part. In the second (scenario B), individuals spend resources trying to influence the state to create the rents they want, while in the third (scenario C), the state takes the initiative in creating rents. For purposes of this research, the first one is irrelevant (Khan and Jomo themselves reckon that it is “rare”).

In turn –and crucially- there are three conditions in scenario B and four in scenario C that would secure the creation of *value-enhancing rents* -in other words, if such conditions do not hold, “bad” rents will always follow.

In scenario B (rent-seeking by influencing the state) the government doesn’t have its own agenda: it simply responds to social/political pressures. Lobbying, bribing, and political pressure are among the most common inputs here: “Thus, on the one hand, rent-seeking through the state involves having the *economic ability* to spend resources to influence the state; on the other, it also involves having the *political ability* to organize effectively, as this is an alternative way in which influence can be exercised.” (Khan and Jomo: 122).

The first condition here (B-i) is that *the spending power of rent-seekers is proportional to their gain or loss*. If this holds, value-reducing rents will be blocked because the group with the biggest loss will be able to spend more than the relatively small group of gainers; concerning value-enhancing rents (which by definition mean a net gain for society) the relatively small group of losers won’t be able to outspend the gainers. But in the real world there are many reasons why this condition may not hold; to start with, the well-identified problems of collective action analysed by Olson. From this perspective, a group with a larger absolute gain or loss may be unable to mobilize more resources if it faces free-rider problems, which in turn is related to size, monitoring and the structure of incentives. Besides well-delimited organization, the failure of this condition to hold is clear when the group of losers is very large and unorganized, such as consumers. Indeed, Khan emphasises that “the failure of condition B-i could explain the existence of inefficient rents in some cases. For instance, inefficient industries may keep getting protection or subsidies because, although their gain is smaller than society’s collective loss, the small number of gainers in the inefficient industry may be able to spend more on lobbying than a diffuse and large group of losers in the rest of society” (Ibid:124).

Condition B-ii states that *the political power of rent-seekers is proportional to their gain or loss*. While some small groups will be able to outspend the larger ones, it is not always the case that political power (in organizational terms) is proportional to economic power. Votes, strikes, protests, riots and ultimately civil war can inflict significant costs to the state, even though these groups are not the ones with the

greatest economic power –for instance, a teacher’s union-. This often leads to the creation of rent-like transfers accruing to unproductive constituencies.

Condition B-iii says that *Political demands for transfers can be met with a stable set of redistributions*. Here, stable means that there is a limited number of strong-enough (as to impose costs to the state) groups and, most importantly, that the set of redistributions does not have to be renegotiated over and over again. Usually this condition breaks because there are many more groups and demands than the state’s resources devoted to redistribution and the former develop strategic alliances in order to enhance their bargaining power. This condition is particularly relevant because it is closely related to monopoly rents: “Monopoly rents are more likely to persist under such conditions because their beneficiaries are likely to share these rents with political factions in exchange for their support. Similarly, rents for learning are more likely to become inefficient if their recipients share them with political factions in exchange for their support in protecting these rents when the state tries to withdraw them.” (Ibid, 127). Bringing this condition into the Mexican case, it is likely that some business organizations (such as CANACINTRA, representing the “new” group of industrialists) whose members were producing substitutes for imports made an alliance with industrial workers’ unions to increase their power and defend monopoly rents on grounds of (avoiding) unemployment. In other words, paying close attention to this condition could help understand the failure of learning rents.

In scenario C the state “acts as an agency in its own right in creating, maintaining or transferring rents” (Khan, 2000:128). The type of rents created will depend upon the following variables: *the motives of decision-makers* within the state, the *transaction costs* they face in collecting payoffs, the *organizational structure* of the state which determines which costs and benefits are accounted for, and the *power of individuals or groups* in society to resist changes which hurt them (Ibid). The set of conditions that should ideally hold for avoiding “bad” rents is as follows:

Firstly, (C-i) *State-officials are value maximizers who learn rapidly from their mistakes*.

It does not matter whether the motives are “good” or “bad” in normative terms as long as they have economic rationality: value-enhancing rents will hardly be created if state officials lack that rationality –but this is only a necessary but not sufficient condition; there is no automatic link between maximizing behaviour and “good”

rents.

Secondly, (C-ii) *The costs of collecting bribes or taxes do not differ across groups*. This is about differential transaction costs: if the costs of collecting bribes or taxes (for the state) are the same regardless of the group's nature –i.e., gainers or losers- the latter can try to block the creation of rents by offering to pay more than the gainers. If, on the contrary, it is easier and cheaper for the state to collect fewer but larger bribes from a handful of gainers, the creation of value-reducing rents makes sense for the state. This might help explain why some governments prefer to allocate rights to a few cronies even when those rents are value-reducing for society (Ibid:130) The problem with this condition is that there is no obvious reason why transaction costs of collecting bribes should be larger in some countries than in others.

Thirdly, (C-iii) *The state's institutional structure allows all costs and benefits to be internalised*. This condition has to do with the degree of fragmentation within the state (independent agencies maximizing bribes and taxes by their own vs. centralized and coordinated decisions) that can lead to a prisoner's-dilemma situation: a firm needs a number of inputs but each of them has a different permit from a different agency, and each agency takes the others' requests (taxes or bribes) as given. Thus, there is the need of all external costs and benefits to be taken into account from the institutional structure's perspective, although technology issues may imply additional difficulties when assessing this. Anyhow, if the state creates value-reducing rents and it is very fragmented, the outcome will be the worst possible, whereas value-enhancing rents being created by a centralized state could result in the best value-enhancing outcomes (provided that other conditions are met)

Finally, (C-iv) condition states that *losers do not have the power to politically resist the state*. This is a crucial condition that overlaps with (B-ii) and whose consequences, when not holding, have been widely recognized in the literature; if losers can in fact resist the state, a number of problems arise: firstly, it means that governments' time horizon will be shortened ("make money fast and get out") with a subsequent increase in value-reducing rents and outright corruption; secondly, it means that even if the time horizon is larger and the government is pushing forward the creation of value-enhancing rents, these will never be created given the excessive costs imposed to the state.

Khan points out that this helps understand the differences between South Korea's and India's performance: while in the former losers were unable to resist the state once rents were terminated, in the latter the factional politics and the ability of losers to flex their political muscles prevented the state from ending rents that were meant to be learning ones. The Indian government knew since an early stage that exports should be promoted and that "infant" industries should be disciplined but, quoting Wade (1984, 1985 and 1989), Khan explains that an over-supply of organizational capacity meant that industrialists could cheaply "hire" 'unemployed factions' for whatever purposes.

In a nutshell, rent-seeking does not produce the same outcomes and does not imply the same costs in different countries given that political conditions and technological trajectories vary and change over time. Moreover, the authors warn about a false dichotomy between pure crony capitalism and pure competitive markets with zero rents: such a benchmark does not exist in the real world, it is insisted. The distinction should rather be between rent-seeking systems which are "*developmental*" and those which are "*crippling*" and the question should be how "one may transform into the other". Therefore, "this is where a deeper examination of the historical evidence is important to warn us against falling for seductively simple theories. There is no evidence in Asia, possibly no evidence anywhere, of long-run development taking place on a no-rent basis" (Khan and Jomo, 2000:141).

The empirical implications of this theoretical framework are, quite evidently, far-reaching, and as such provide a powerful balance to the categorization derived from the neo-classical theory of rent-seeking. First of all, it means not to discard *a priori* the possibility of value-enhancing learning rents, since the evidence show that these have taken place, and worked, in South East Asia. Second, it implies paying particular attention to the *final outcomes* –particularly in the long-run- of rents instead of focusing exclusively on its immediate *inputs*. Third, the role of conditions – particularly B-i and B-ii- is of uttermost relevance for understanding rent-seeking within the economy as a whole: many of the apparent negative outcomes may have more to do with the balance of power across actors, groups and constituencies –and the subsequent redistributive tensions that arise- than with an economic entitlement *per se*.

3 CONCLUSIONS

There are conclusions at three different levels: first, at the *historiographical* one, regarding Mexican business politics in general and regarding the import licensing system in particular; second, there are *theoretical* insights from the large literature on rent-seeking; third, the synthesis of the two previous levels also leads to *methodological* implications.

To begin with, there is not only scant research on the licensing system, but the research done so far lacks depth and detail: not even the basic descriptive statistics of items being under control, and its change over time are available. Furthermore, King (1970), Bueno (1971), Izquierdo (1973), Vazquez Tercero (1966) and others agree that the licensing was a sort of a “black box”: neither its inputs nor its outputs were known. They also leave clear that, to a greater or lesser extent, such system was in fact granting redundant protection to some firms –especially if they were all too willing to comply with the government’s agenda, or too big to risk a confrontation with.

Evidently, this is in line with the theoretical insights, and to some extent, with the evidence presented by Krueger with respect to the import licensing in India and Turkey. Above all, is the basic approach of a license as a “valuable commodity”: thus the interest of industry representatives to have a seat in the licensing committees. In that sense, getting a license for importing a final good (to be re-sold with a substantive mark-up) would amount to rent-creation; getting a license for intermediate goods and raw materials would, in many cases, amount the process of Rising-Rivals’-costs described by the Theory of Economic Regulation, whereas rent-extraction could take place at high levels –such as SIC officials threatening to free trade- to the day-to-day operation of the customs in particular and red tape in general. Both Tullock and McChesney emphasise the diversion in the long run of human capital away from higher education and toward bureaucratic positions, a phenomenon which the literature on the effects of Rent-seeking on economic growth has consistently identified as rather damaging to the latter.

This is also a crucial point at which the way the PRI operated, and the theoretical insights from rent seeking get in line. The staggering growth of the political bureaucracy under the PRI, measured by both the share of the public sector over GDP and the share of public employees over the total workforce, leave no doubt about the fact that rents, of some sort or another, were being distributed. From jobs for life, discretion over budgets and lucrative positions equivalent to tax farmers to outright economic entitlements, prizes would sustain the hegemony from within.

This is all the more likely taking into consideration the political system: an extremely centralised presidency with a puppet Congress unable or unwilling to challenge the executive; a pragmatic approach to sustaining legitimacy and hegemony by any means, thus privileging negotiation vis-à-vis the private sector. For its part, the business community, rapidly growing in importance after WWII, was not, on the whole, too confrontational, but given the circumstances it could threaten the government with job layouts that would seriously undermine the party's legitimacy. Even within the party, rents would have to be distributed as reward to key, loyal figures and their respective entourages.

Summing up, there were rents to be made with, within or extracted from the party; following Krueger, it's about not only the import licensing which would fall under the "legal" side, but also all other paralegal or outright illegal activities such as smuggling (which is analysed in Chapter Four). Conceptually, keeping such wide continuum equals to including both *rent-creation and rent-extraction*.

Translated into a particular methodological framework to deal with both the licenses in particular and trade restrictions in general –that is, the rents accruing from them– the three following categories will be used:

-Monopoly rents: that is, import-licensing (along with tariffs) used as a device to create artificial scarcities by getting rid of foreign competition; a captive market for one or few firms. Conceptually, what matters here is that rents are accrued at the expense of consumers and that they are the indirect outcome of licensing, as opposed to those who actually exercise the right to import banned items.

-Rising-Rivals'-Costs Rents: in this case, import-licensing is used to get an artificial advantage vis-a-vis other firms within the same industry: prices need not to be raised, as the firm's costs will be kept lower than those of its competitors. That is, rents at the expense of other firms

-“Money-for-nothing” rents: these are payments often exacted as plain extortion or blackmail: can take the sophisticated forms of threats to reverse particular policies or measures or the straightforward form of asking money *not to* retain goods at the customs even though all the legal requirements have been met: it is literally *money for nothing*.

This categorisation will be particularly relevant for Chapter Three, which deals with the qualitative evidence gathered in the archives on individual industries. However, by acknowledging the debate regarding East Asia Industrialisation and the heterodox approaches to rents and rent-seeking, the empirical evidence will also be analysed in terms of potential *learning rents*.

3 CHAPTER TWO

The macroeconomic context of the import-licensing system in Mexico -from WWII to the debt crisis

“It remains a paradox that industrialisation, instead of helping greatly to soften the internal impact of external fluctuations, is bringing us to a new and unknown type of external vulnerability” Raul Prebisch, (1961:21)

“The process of Latin American industrial development was always ad hoc. Governments did not grant trade protection because they were committed to a particular vision of industrial development. They did it because they were rewarding politically powerful constituencies, some of whom were industrialists and some of whom were industrial unions.” Stephen Haber (2006:584)

ABSTRACT: The aim of this chapter is to describe and analyse the economic background of the post-WWII period. As such, it provides a broad overview of the country's macroeconomic performance and, to some extent, the policy responses that would shape much of the period. Particular attention is paid to balance-of-payments in general and trade balance in particular, in the context of import-substitution industrialisation. Primary sources are extensively used –yearly reports by the central bank, (BANXICO) in addition to other official publications- and complemented with analyses from secondary sources.

The inception of trade control instruments in Mexico has to be understood as inextricably related to the economic consequences of the Second World War in general and to balance-of-payments difficulties in particular. The main argument, broadly supported in the literature, is that the Mexican government implemented temporary measures to ease the trade deficit; however, after a few years these became a core policy tool since it was conducive with the industrialisation strategy and because there was a great deal of political pressure *not* to reverse such supposedly *temporary* measures. It has to be noted that older accounts of ISI tend to emphasise the industrialisation narrative while more recent perspectives –such as the *Cambridge Economic History of Latin America*, Haber (2006) and the *New Political Economy* approaches to industrialisation- emphasise and provide evidence for the “political pressure” narrative. Rather than providing evidence in either

direction, this chapter is concerned with establishing the macroeconomic context of ISI in general and of the import licensing system in particular.

3.1 Mexico and the Second World War

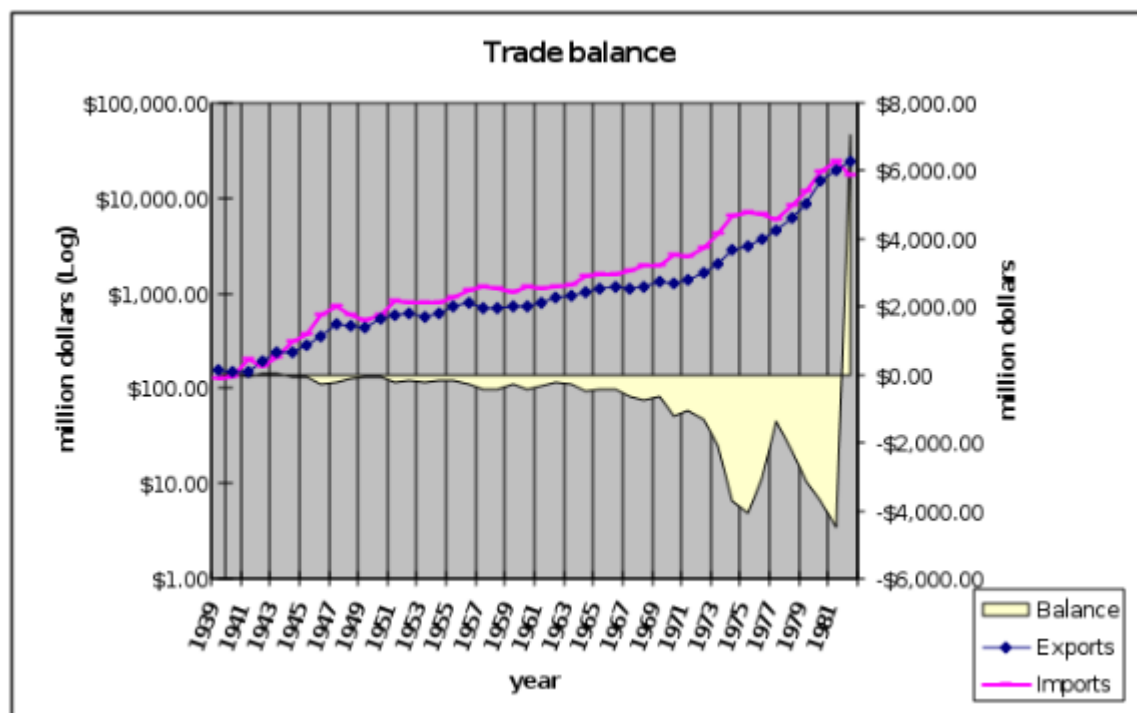
It has been pointed out that the economic isolation created by the war triggered, at least partially, the ISI processes amongst Latin American countries. However, the evidence on Mexico provides an opposing view: by having the US as neighbour, Mexican trade was not restricted in principle and in fact it became an important source of supplies for the US economy. Furthermore, financial capital fleeing risky areas flowed into the country, triggering a significant monetary expansion: in 1940 alone the real money supply grew 20 per cent (BMYR, 1940:18). These factors combined fuelled growth, strengthened trade and significantly altered the structure of the economy: driven by US demand, exports increased 48 per cent between 1940 and 1945 (Ortiz Mena, 1953:298) and, moreover, its composition went through significant change by reducing the proportion of minerals exported –which so far had accounted for 70 per cent of all exports- and by increasing the proportion of manufacturing exports from only 7 per cent at the beginning of the war to 38 per cent at the end of it; an increase of 850 per cent in terms of volume (Ibid:397-401; Cardenas, 2000:183).

Table 1

Year	Exports	Imports	Balance
1939	807.3	663.7	143.6
1940	794.9	712.8	82.1
1941	722.2	967.5	-245.3
1942	946.5	835.4	111.1
1943	1156.2	1028.9	133.4
1944	1359.3	1508.6	-352.4
1945	1674.9	1806.8	-447.5

Source: BANXICO yearly reports.

Figure 1



Source: data from Banxico (1939-49) and Estadísticas Históricas de México (EHM)

Not surprisingly, GDP growth averaged 5.2 per cent during the war, and industrial GDP averaged 7.2 per cent (Ortiz Mena, 1952: 397-401). In per capita terms, GDP went from \$3,570 to \$4,165 at the end of the period. Evidently, the war contributed significantly to this take-off.

Table 2

Year	GDP (pesos)	(1970 per capita
1939	68989	3570.859
1940	69941	3558.795
1941	76753	3800.594
1942	81059	3906.27
1943	84061	3942.269
1944	90923	4149.84
1945	93779	4165.364

Source: EHM

The downside of this bonanza was an even higher growth of imports: it averaged 22 per cent between 1939 and 1946. To some extent, it was unavoidable as new investments required more imported capital and intermediate goods. Nonetheless, it was the beginning of the chronic current account deficit which would later justify measures such as tight import controls.

Analysing in more detail the composition of imports, it is worth noting that both consumer and capital goods augmented their respective shares over total imports: from 24 per cent to 28 per cent at the end of the war, while intermediate goods and raw materials decreased their share a few points. The 1945 BANXICO Report highlights the increased quantities of imported machinery and industrial products, to the extent of stating that “huge quantities of chemicals entered the country; in consequence, to avoid an even more dangerous *invasion* (for the domestic industry) the state found itself obliged to classify those products as of requiring a license, given that they are already being produced in the country” (BMYR, 1945:11). This is the first mention of licenses; as such, it was a temporary measure not yet enacted by law.

The following year (1946), the data as well as the rhetoric in the reports suggest that imports were quickly becoming a political issue. To begin with, the value of imported luxury and durable goods (at the time a single category) skyrocketed: from 31.8 million pesos in 1939 and 86.6 in 1945, to 227.5 million pesos in 1946. To put that

figure into context, the total deficit that year amounted to -447 million pesos, which means half of it came from “superfluous” goods -luxury cars, carpets, colognes, red wine, whiskey and so on.

The 1945 report’s section on trade policy makes clear that commerce was starting to be a clashing point between developed and developing nations as well as in domestic politics terms. It mentions “two tendencies”, the multilateralism that promoted free trade and that of the rest, namely, those nations whose interest is “to protect their industrial development”, the implication being that Mexico would no longer agree to sign trade agreements and was in fact ready to drop out from the one signed in 1943 with the US (Mexican industrialists had always openly opposed the agreement, which was dropped in 1950). The following quote illustrates the point neatly:

“The risk that a whole sector of the national industry disappears should the flow of foreign merchandises continue poses to the state the challenge of revising tariffs (...) All countries care about their basic activities to maintain economic stability and to guard themselves from eventualities; therefore, it is not unlikely that the government will take corrective measures to end any damaging situation, either for national activities or the stability of our currency” (BMYR, 1946:13)

The biggest private bank –Banamex- included an interesting mention of the issue in its annual report to shareholders. Commenting about the 1947 Conference that would create the GATT, in the Havana, they pointed out that Mexican Officials agreed “in principle” with the idea of free trade, but at the same time wanted exceptions –Mexico as a whole being one of them: “Mexican officials have declared, in a very unequivocal manner, their intention to maintain an *elastic* policy, capable of accommodating the demands of progress” (BNX, 1948:20 emphasis added)

Mr Ortiz Mena, who would become minister of the Treasury a few years later and was known as a big advocate of ISI in Mexico, explained in 1953 why Mexico did not join the GATT: “despite our non-discriminatory (trade) policy, this administration has consistently refused to join, in order to keep our freedom and to implement any policy considered as necessary for protecting its incipient industries” (Ortiz Mena, 1953:425). Such freedom was not only about granting protection to relevant constituencies but also about setting the import tariffs according to the fiscal needs

of the state, a practice blatantly contradictory of the GATT principles. In fact, this very reason was the one why the Mexican government abandoned the trade agreement signed with the US in 1943.

Still, it was clear that the trade deficit was indeed growing too fast: for almost 40 years after the war there was not one with trade surplus, and the deficits in 1946 and 1947 were sizable indeed (table 3, below). In 1944, the first year of deficit since 1941, it represented -72.6 million dollars, only to increase to -92.2 and -255.3 million dollars in 1946 and 1947, respectively (Ortiz Mena, 1953:397). Partly explained by the overvalued peso, the growing deficit started draining the central bank's reserves at a worrying speed; a decrease of 40 per cent in 1947 (BMYR, 1947) only was enough as to trigger a government response.

The risk of running out of reserves, combined with the commitment to a fixed exchange rate regime and a new president –Miguel Aleman, who had cosy relations with the industry and who was an enthusiast of industrialisation with nationalistic tones- prompted in 1947 two substantial changes in trade policy. First, after having noted the effect of inflation on nominal tariffs, the government decided to implement a system of combined rates: from then onwards, a product's tariff would be a specific nominal percentage plus the *ad valorem* percentage, with the added element of official prices to avoid tax evasion via undervaluation. Second, virtually all items under the category of luxury and durable goods (which in 1946 represented 18 per cent of all imports) were banned from importing and declared under a licensing system.

The 24th of April, 1948, the Executive Office published in the DOF a decree entitling the SIC the authority to include or exclude any item from the lists of banned products (DOF 24/04/1948), which effectively marks the beginning of the import licensing system that would survive until the late eighties.

However, these measures were not enough to bring the deficit under control for a number of reasons. First and foremost, by starting new assembly plants for manufacturing goods, demand for intermediate and capital goods, as well as raw materials, soared. For instance, cars were included in the first list of licensed imports, so domestic production jumped from 10,460 units in 1946 to 21,597 only two years later (Izquierdo, 1970:248). Evidently, such rapid increase in production

would entail more imports since the country did not produce the whole range of inputs for motor vehicles. By 1948, the deficit reached -133 million dollars, and the central bank reserves shrank 67 per cent compared to 1945 (BMYR, 1949). As a result, devaluation became unavoidable. In June of 1948, the peso was allowed to float, and it immediately started losing value. One year later the government set a new fixed rate at 8.65 units per dollar, from the previous 4.85 –a depreciation of 80 per cent.

Even though the trade balance could not be turned positive, it was kept below the 1946 and 1947 levels for another ten years or so. Moreover, the value of luxury goods went down to 22.3 and 20.1 million dollars in 1948 and 1949, respectively (Ortiz Mena, 1969:415). Evidently, that was the effect of the new licensing system.

However, these changes in trade policy clashed with the commercial agreement signed with the US in 1943, and the Mexican industrialists started pressing the government to drop out of the treaty. Anti-free-trade references became more and more frequent after 1948 –quite possibly once the government had shown that profitability can come from a few policy changes-. The private banking industry noted on their 1950 assembly report the following:

“Mexican industrialists have repeatedly expressed their opposition to the agreement, pointing out that its terms and conditions were detrimental to the economy, given the lack of freedom to protect and foment industrial development. In this context, both governments opted out the agreement” (Banamex, 1950:25)

In sum, it was not only the reaction to the 1946 and 1947 deficit, but also the fact that from 1950 onwards there were virtually no legal restrictions to trade barriers. In consequence, the trend deepened significantly the next decade. As it will be shown, in the years to come the rationale behind including particular items under the category of banned (licensed) items was no longer about trade balance but about domestic politics: as Cardenas puts it: “as soon as a domestic company, of either national or foreign capital, started producing certain goods which until then were being imported, the government would establish import quotas to protect it” (Cardenas, 2000:187). The central bank would hint the virtue of prohibiting imports arguing that the expansion of the domestic markets was an important pull-factor for

manufacturing industry (BMYR, 1950). Thus, the transition from a temporary measure to an actual strategy had been made.

3.2.-The fifties: The Korean War, growth and optimism

By 1951, international reserves were dangerously low again, although this time it was partially motivated by an external event: the Korean War, which Mexican industrialists had interpreted as the prelude for higher prices for US commodities. The rush to stocking is clearly reflected in the numbers: the trade deficit went from 63 million dollars in 1950 to 230 in 1951 (EHM). Imports grew, overall, 49 per cent in that year only, and some categories had even higher rates: food stuffs augmented 67 per cent, while capital goods and raw materials grew 52 and 48 per cent respectively.

Concerning growth, the strategy of stockpiling, along with the substantial demand peak from the US, paid off: in 1952, the GNP grew 14.8 per cent (BMYR, 1952) and GDP per capita went from 4,830 pesos (base 1970) in 1950, to 5,101 two years later, an increase over 6 per cent. Although there was again a trade deficit, it shrank 32 per cent compared to the previous year. BANXICO explained the trend in the following terms: "The industrialisation process that has been undergoing during the last twelve years has required, and will require, increased volumes of imported capital, intermediate goods and raw materials. This fact implies a negative trade balance, as it should be for a developing nation." (BMYR, 1952:36)

In the same report there is a mention about the licensing system and its expansion to raw materials and intermediate goods, emphasising that such system was needed to ensure that only producers had access to imports and not middlemen, whom –the government insisted- were responsible for high prices.

The following year -1953- there was a widespread downturn in international commodity prices. The effects on trade balance were two-folded: lower dollar revenue and increased total imports –mostly via increased importation of grains.

The private sector was aware of the worsening of both structural problems of the Mexican economy; in a congress of industry chambers the same year, they highlighted the risks associated with exporting 79 per cent of exports to the US, while 82 per cent of all imports had the same origin (CNIT, 1953:344). Furthermore, the growth of manufacturing exports was practically nil, making the country dangerously dependent on low value-added and highly volatile goods.

The chronic deficit was becoming, once again, unsustainable; between 1951 and 1953 the Central Bank reserves lost 55 million dollars, whereas in the first three months of 1954 the loss amounted 43 million (Ibid,1955:25). The government had no choice but to devalue; although this time was not as severe as the one in 1948: it lost only 30 per cent of its value against the dollar, whose value was fixed to 12.50 pesos (BMYR, 1955:24).

Devaluation, along with an exceptionally good harvest, increased tourism flows and strong investments made of 1955 one of the best years on record. Optimism within the government was unlimited but it had dire consequences in the long run as there was no serious attempt to avoid future balance-of-payments crisis. The reasons for optimism are clear: GNP grew 9.9 per cent whereas GDP per capita jumped 6.9 per cent (BMYR, 1956:11). But a closer look easily reveals the weaknesses: of all exports, raw materials accounted for 71 per cent, agricultural products for 24 per cent while others a mere 5 per cent (Ibid:25).

In short, throughout the fifties the trade balance was consistently negative despite a significant reduction (in relative terms) of imported consumer goods, given the ever-increasing demand for raw materials and capital goods. However, the government was confident that it would maintain a reasonable equilibrium in the balance of payments by covering the trade deficit with other sources of hard currency from the capital account, which at the time looked not only stable but growing. This explains to some extent the lack of growth both in exports and in its value added.

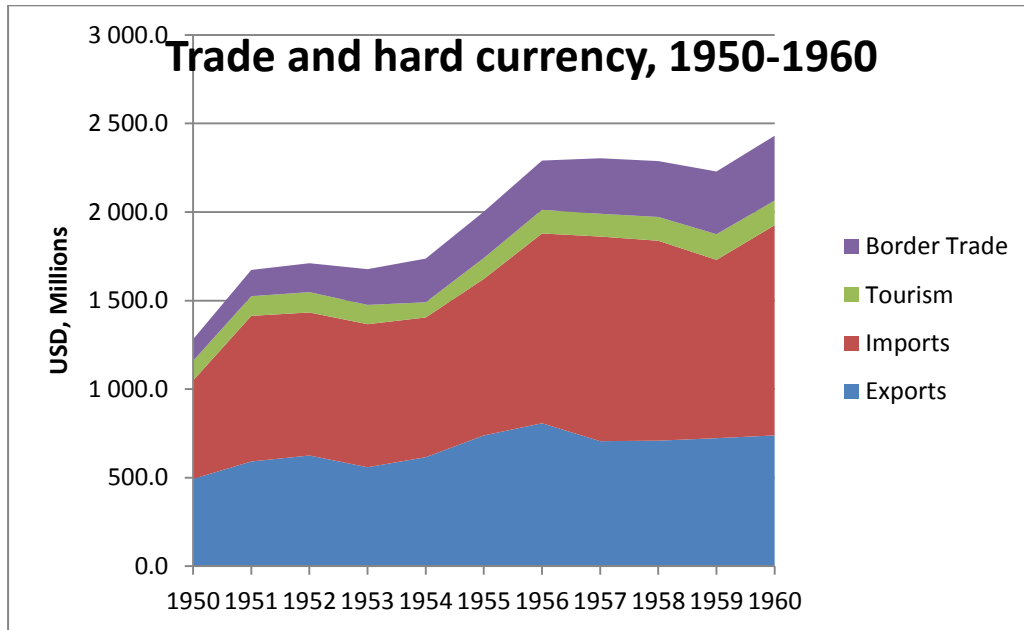
Table 3

Year	Imports	Exports	Balance USD
1950	597.3	533.8	-63.5
1951	822.2	591.5	-230.7
1952	807.4	625.3	-182.1
1953	807.5	559.1	-248.4
1954	788.7	615.8	-172.9
1955	883.7	738.6	-145.1
1956	1071.6	807.2	-264.4
1957	1155.2	706.1	-449.1
1958	1128.7	709.1	-419.6
1959	1006.6	723	-283.6

Source: BANXICO, yearly reports

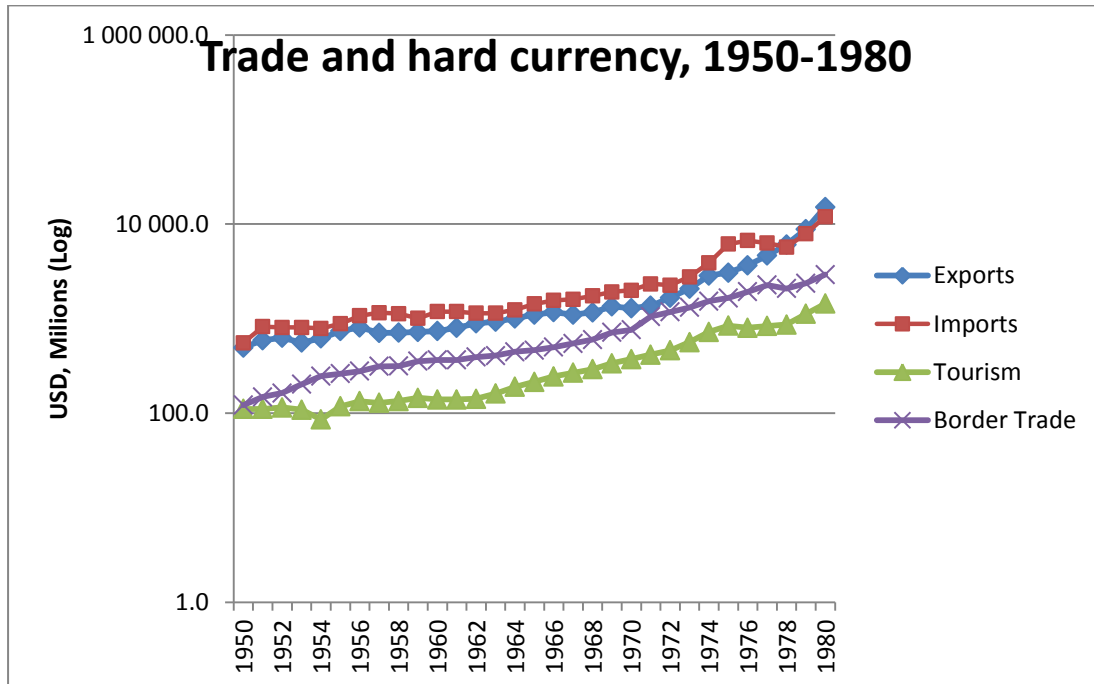
In decreasing order of importance, those sources of hard currency from the capital account were i) border transactions ii) tourism and iii) remittances from migrant workers under the 1942 agreement with the US –the Bracero Programme that would last until the sixties. The statistics of the balance of payments does show the increased dependency upon such sources -especially regarding the border transactions: they passed from 121 million at the beginning of the decade to 354 million at the end of it, while tourism revenues went from 110 million to 145, and exports from 826 to 1319 million. (Nafinsa, 1974:366-67)

Figure 3



Source: EHM

Figure 4



Source: EHM

From table 4 it is clear that exports had a rather modest growth rate until the seventies, while border trade and tourism had the highest rates. Although the government did not see this much of a problem, some government agencies started to warn about the risks implied by perpetuating this balance of payments dynamic. In particular, the Bank for Foreign Commerce (*Banco Nacional de Comercio Exterior*) which at the time oversaw all the permits and regulations for exports, noted in its 1957 report: “The deficit on the trade balance has been offset, to a large extent, with the current account; predominantly, \$357.7 million dollars earned from tourism and border transactions” (BNCE, 1957:20)

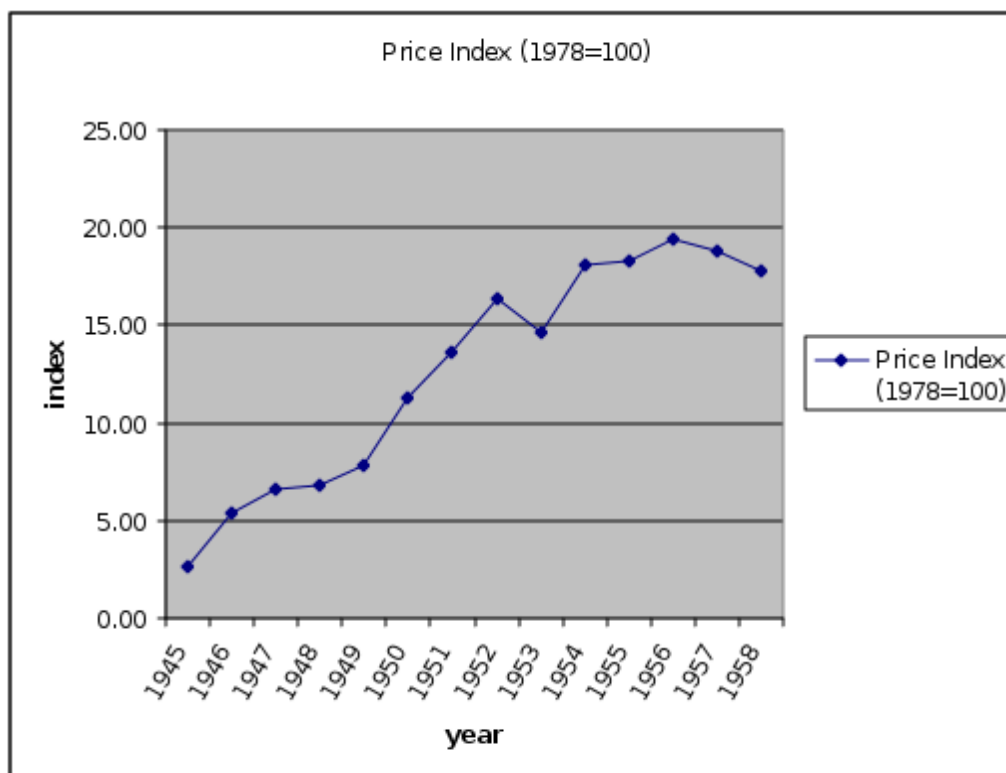
The report goes on and emphasizes –on the structural fashion of the time- the secular decline in the terms of trade; as well as warning that eventually imports would have to be halved as a result of the dependency on exports with high price volatility. The conclusion is logical: the Government should support not only exports in general but encourage a higher value-added proportion on them (BNCE, 1957:21).

Another crucial shift during this period was that of import demand from gross fixed investment; encouraged by steady public investments –particularly in infrastructure- subsidies and trade protection, the private sector started to invest heavily in large-scale industry. This, in turn, meant significant increases in imports, both in absolute terms as well as in the private sector’s share over total imports. In one year only – from 1954 to 1955- imports of capital goods by the private sector jumped from 1,592 million pesos to 3,053 million in 1955. Total imports amounted for 3,901 million, which means that $\frac{3}{4}$ went to the private sector alone.

The core economic trends of the fifties can be summarised as follows: high growth rates along with relatively high inflation. Fundamental to both trends was the Korean War that replicated the WWII pull-effect for Mexican exports and that implied a substantial flow of liquidity to the country. This, despite the central bank’s efforts, pushed inflation higher than desired. After the war, balance-of-payments difficulties forced monetary authorities to devalue the peso, somewhat unexpectedly but at any rate successfully. Its nominal value was fixed in 1954 at 12.50 pesos. In addition to devaluing, all import duties were raised 25 per cent as a “transitory measure” that would, nevertheless, become permanent for many products. In spite of these

measures, the trade deficit only worsened during this decade; imports grew almost twice as fast as exports, and 1957 saw a new record on the deficit, amounting to 449 million dollars and 419 in 1958. On the positive side, gross formation of fixed capital grew from 13.6 to 17 per cent during the fifties; total investment increased at 7 per cent annually –with a substantial share of the private sector- while the accumulated deficit of the public sector amounted only .3 per cent of GDP (NAFINSA, various years; EHM; Fernandez Hurtado, 1965). Also, labour productivity grew 3 per cent annually, while real wages did it at 2.2 per cent.

Figure 5



Source: BANXICO (1950-1959 yearly reports)

Regarding industrial policy, the fifties saw a number of significant changes. Amongst the most relevant ones, the *Law of New and Necessary Industries* stands out as a crucial element in the industrialisation strategy. It had been enacted back in the early forties to support small and medium firms in the context of the war: the government wanted to diversify manufacturing production both to take advantage of the increased US demand. By 1955, however, the Law was significantly reformed; formally the rationale was to have a clearer definition of the terms “new” and “necessary” but in practice it was about legalising some of the support mechanisms that were already in place.

As such, “necessary” industries were defined as those devoted to exporting and/or assembling, while “new” meant products that were not being produced at the country by then (NAFINSA, 1971:204). Furthermore, support was given through “franchises” that would often include tax breaks; such franchises had a time frame of five, seven and ten years depending on the category: basic, semi-basic and secondary industries, respectively. However, the law itself included an article on the possibility of extending the franchises on a discretionary basis as long as the firms in question were of high importance (“*primordial importancia*”) for the country’s development” (Ibid). Of course, there was no mention, in concrete terms, of which industries qualify as such and which ones do not. In addition to this law, the same year an important tariff was modified: Rule 14th of General Tax to Imports, which was partly established as a response to the excesses of tariff policy and partly as an incentive for setting up new industrial plants in the country. Concerning the former, the problem was that rules for importing, as well as nominal tariffs, would often assume that a product’s components would be independent items. Often, then, the importation of capital goods was blocked on the grounds that one of its components was already produced in the country.

Rule 14th did not completely solve this problem, but at least lessen it by explicitly allowing the importation of the “whole” product when it is machinery for production. Also, it granted a 75 per cent reduction in the tariff to be paid (Ibid: 206) Finally, it is worth noting that the year of 1958 marks the shift in ISI –see Villareal, 1971, 1974, 2006- from the “easy” or “horizontal” stage to the “vertical” or “advanced” stage by which intermediate and capital goods started to be produced

domestically at a significant scale (this would often imply foreign direct investment as indigenous technology was scarce or, in some cases, simply non-existent). Two core measures stand as important evidence of this shift. First, the import-substitution index (see Figure 6), that measures the share of imports in an industry as percentage of total supply; second, the income-elasticity of the demand for imports.

Concerning the first measure, it is clear that the period 1939-1950 was one of substitution of consumer goods: the share of imports in the total supply of consumer goods decreased 69 per cent, while the reduction of import content in intermediate and capital goods was 26 and 18 per cent respectively (Villareal, 1974:58). From 1950 onwards the import index for the manufacturing sector remains more or less constant, while intermediate and capital goods diminished its import content by 2 and 5 per cent. despite the relative stagnation, it is clear that consumer goods benefited the most from the substitution strategy: by 1958, the import index for these products was only 5.72 (from 22.2 per cent in 1939) while intermediate and capital goods went from a 55.9 per to 40.3 and from 90.2 to 68.6, respectively (Ibid). Evidently, by that year there was plenty of room for substitution in the latter cases than in the former.

Villareal (1974, 2006) points out that in 1958 there was a structural break in the process of import substitution; for the period 1945 to 1957, the income elasticity of import demand was very high -1.50, which means that any extra dollar earned would generate a demand for imports totalling 1.50-. From 1958 onwards, such elasticity lowered significantly -down to .81; a similar measure, the marginal propensity for consumption of imports, shows the same trend: at the end of Second World War, from every 100 dollar increase in national income, 22.6 were spent on imports, while by 1958 it was only 6.30 dollars. However, the mean propensity for the economy as a whole to consume imports remained practically the same between 1945 and 1958, given the fact that there were new needs for new imports that would cancel out the gains from substitution in consumer goods. It was only after 1958 that the mean propensity went down, as well as the marginal propensity.

Summing up, the fact that the income-elasticity of demand of imports was higher than one -in other words, that imports grew faster than income- between 1945 and

1958 means that ISI was launched at the cost of a significant but unavoidable external disequilibrium. After 1958, once the elasticity fell beyond one, the trade imbalance is not explained entirely by the inherent import-intensity of the process.

3.3- The long decade of the sixties: (1958 to 1971) Growth and growing imbalances

The period 1958 to 1970 coincides with the twelve years of Antonio Ortiz Mena as Secretary of the Treasury (*Secretaría de Hacienda*), during the López Mateos administration (1958 - 1964) and then Díaz Ordaz (1964-1970) –such continuity was highly unusual since a new President would bring his own team. It also matters since the core economic strategy was in fact authored by Mena himself as part of the López Mateos campaign programme; once in office, the President approved the plan and gave Mena ample powers well beyond the Treasury's traditional role –for instance, tariffs were in fact under his control.

The period has been labelled as “Stabilizing Development” (*“Desarrollo Estabilizador”*) to emphasise that, in contrast with the fifties, there was neither high inflation nor devaluation. As such, it is the “golden age” in Mexican development that many authors highlight as a success: “The macroeconomic performance from 1940 to 1970 was undoubtedly impressive. The strategy on which it was based tackled important obstacles on the road to Mexico's development. However, it ignored or underestimated the magnitude of other obstacles” (Moreno Brid and Ros, 2004:17). Such obstacles, critics would insist, were known but the government did not change strategy (increased protectionism, avoidance of devaluation and increased borrowing from abroad) mostly for political reasons. It was what Vernon cleverly summarised as the “Mexico's dilemma”: eventually, the government would face political risks and opposition given a stagnant economy; however, making corrective changes –namely, partial liberalisation– would have had huge political costs in the short run.

At any rate, there is agreement in the literature (Cardenas [1990,1994,2000], Villareal [1971,1977,2006] Bueno [1971] Balassa [1971] Schettino [2007]) regarding three major obstacles: i) the loss of competitiveness of manufacturing industry, ii)

the stagnation of agricultural sector and iii) increasing government indebtedness – worsening of public finances in general.

Table 4

Year	Imports	Exports	Balance
1958	1128.7	709.1	-419.6
1959	1006.6	723	-283.6
1960	1186.4	738.7	-447.7
1961	1138.6	803.5	-335.1
1962	1143	906.5	-236.5
1963	1239.7	944.1	-295.6
1964	1493	1026.7	-466.3
1965	1559.6	1126.4	-433.2
1966	1602	1169.9	-432.1
1967	1736.8	1102.9	-633.9
1968	1917.3	1165	-752.3
1969	1988.8	1341.8	-647
1970	2500.5	1289.6	-1210.9

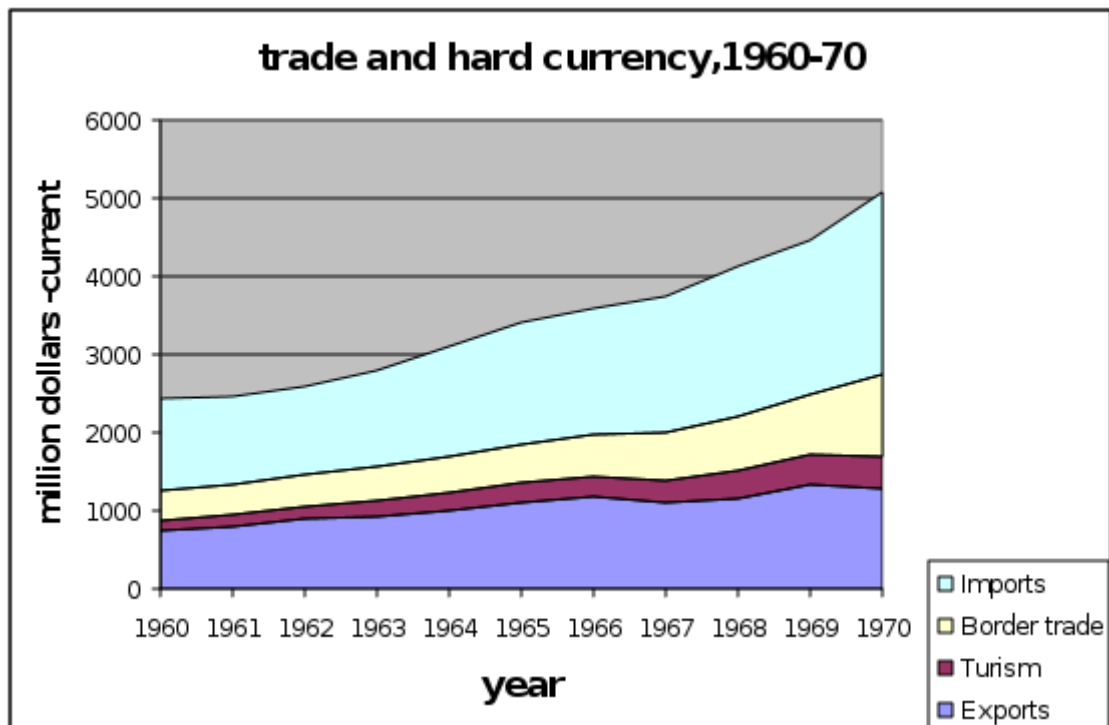
Source: EHM

Table 5

Year	Growth GDP per capita, %
1958	1.61
1959	-0.91
1960	5.32
1961	-0.36
1962	0.59
1963	6.01
1964	10.04
1965	2.2
1966	2.76
1967	2.41
1968	5.43
1969	0.77
1970	3.19
1971	1.11

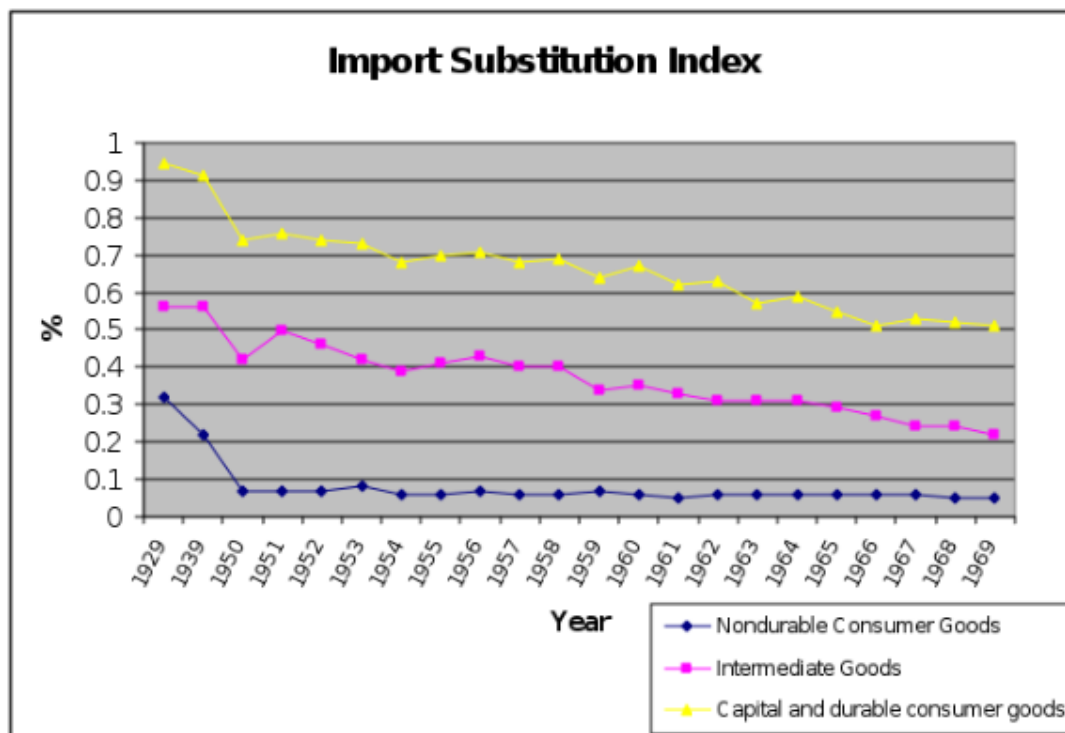
Source: Penn Tables

Figure 6



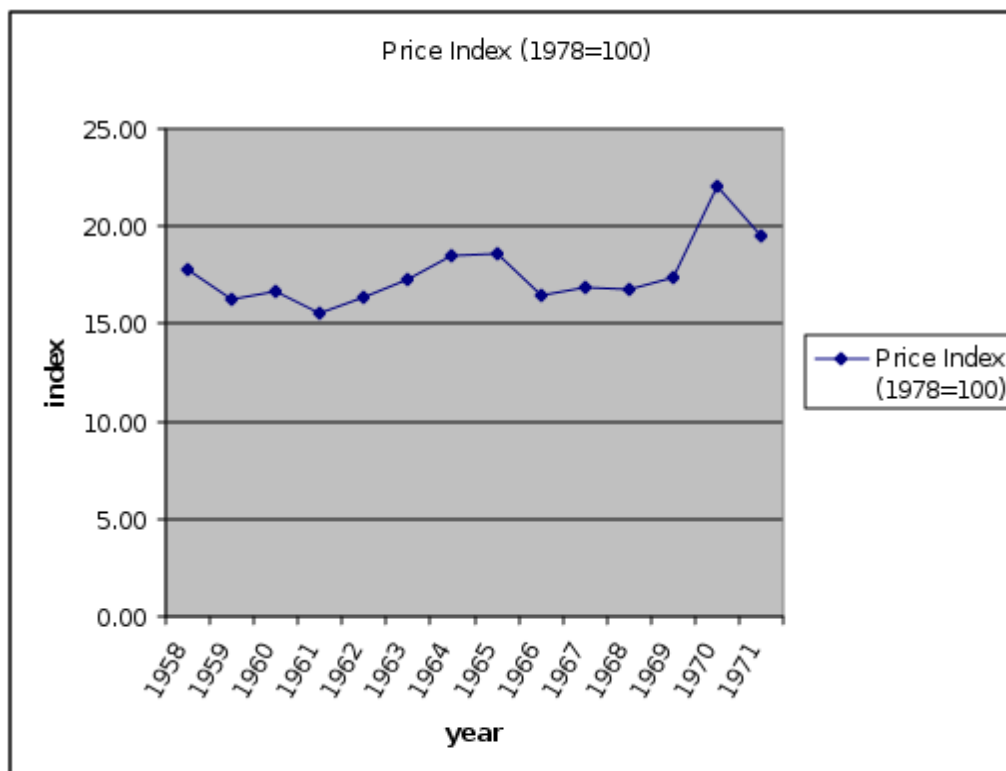
Source: EHM

Figure 7



Source: (Villareal, 1977:73)

Figure 8



Source: BANXICO, 1960-1972 Reports

Before analysing such obstacles, it is worth summarizing the general trends, as well as to describe the positive features. President López Mateos took office in 1958 after one of the best years of economic performance in history. The successful devaluation of 1954, combined with good prices and good harvests meant that product per capita grew 5.6 per cent on average from 1954 to 1957.

Heavy public and private investment was paying off: in 1960, construction sector grew 13 per cent in this year alone, which in turn pushed the metallurgy and cement industries by 15 and 17 per cent, respectively (BMYR, 1960:14). The manufacturing sector as a whole grew 9 per cent, with important increases in crucial producer goods –such as fertilizers, chemical products, synthetic fibres and trucks- which were, indeed, substitutes for imports. Not surprisingly, GDP per capita grew 5.3 per cent. In contrast, the sluggishness of export growth in a context of ever increasing imports is also clear. Furthermore, despite the growth of the invisible components of the capital account, the deficit could not be reduced. Thus, by 1960 the curse of indebtedness was already at sight, as the following passage from the Central Bank

annual report summarises this point: “Just as during the last four years, manufacturing exports remained stagnant in 1960, in contrast with the growth rates of both imports and the economy as a whole. Because of this, closing the deficit relayed relatively more on increased earnings from the capital account; public, private and foreign lending increased, the latter by 54.6%” (BANXICO ,1960:17). Putting the gap between imports and exports in perspective, it is worth noting that in 1960 alone imports grew by 18 per cent while exports less than 2 per cent.

The year 1964 saw a record 10 per cent growth of total GDP, certainly a high number by any standard. Critics of ISI often point out that it was mostly luck: the period itself coincides with the highest sustained growth of the world economy, including the US. The data does indeed show that sources of growth were mostly external and that the country was indeed lucky. However, it also reflects the fact that the domestic market was growing fast as urbanization and salaried workers were both on the rise. The Central Bank acknowledges that both an unusually good rain season plus a substantial increase in US demand explain most of the 10.04 per cent growth; total demand went increased 17 per cent, but external demand alone accounted for the biggest share and increase: 7.4 per cent (BMYR, 1964:16).

Performance for the rest of the decade was not as high but it was, nevertheless, substantial: 5.1 in 1965 per cent for Gross National Product (BMYR, 1965:15) and 2.2 in per capita terms. Moderate growth, inflation lower than 5 per cent, widening trade deficit and increasing debt would be maintained for the next three years, until 1968 when growth was outstanding again: 7.1 per cent of GNP, while 5.6 of GDP per capita (Penn Tables). Almost all of such big-scale projects were funded by the government through NAFINSA public fund created back in 1934 but that started to play a more significant role since the passing, in 1955, of the Law of “New and necessary industries” and, moreover, since the early sixties when its budget started to grow significantly and steadily. By 1968, the total budget had increased 13 per cent compared only with last year, to amount 36,151 million pesos (NAFINSA, 1970:13). This figure represents slightly more than 10 per cent of GDP that year, a very substantial share. Not surprisingly, gross formation of fixed capital grew at annual rates of around 10 per cent (although not since 1958 but from 1963). In this

sense, NAFINSA's role in the economy was overly important and it is acknowledged as a successful case of financing industrial development.

Nonetheless, at least two elements of its policies would become a source of trouble later on; first, -and as pointed out by Cardenas (1994)- the strategy of credit for shares was mishandled. As a result, performance was rather poor, given the guarantees given by the state (i.e., moral hazard). Second, the state ended up owning too many firms across different industries, a goal beyond industrial policy. In many cases, these state-owned firms became a drain of public resources: loss-making companies that were maintained either because of employment considerations or mere corruption. In addition, NAFINSA started to borrow heavily in dollars, at variable interest rates. In fact, in 1968 alone more than one third of its funding came from international creditors, a source that accounted for more than ten times its own reserves (NAFINSA, 1968:18, table 2)

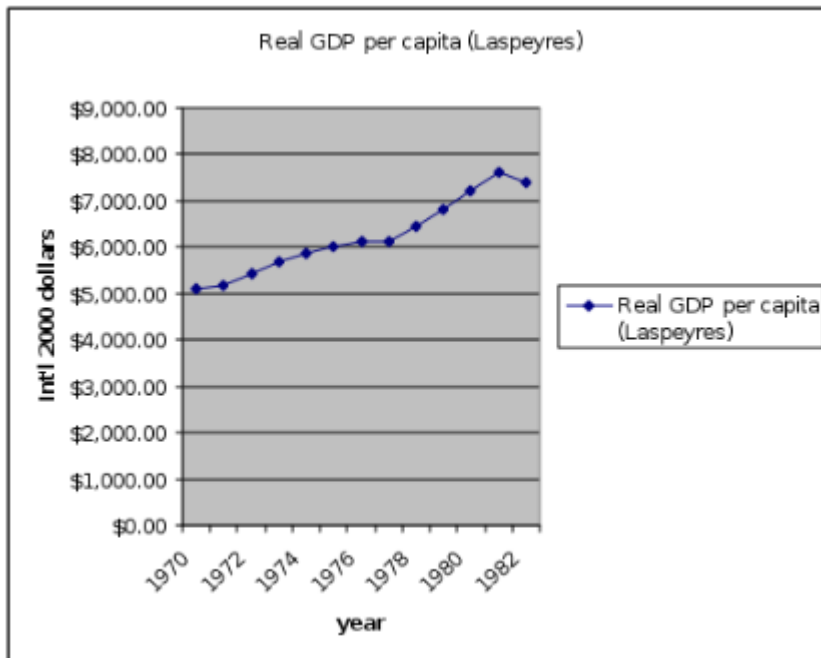
By the end of the decade, over-confidence was leading to risk-taking well beyond what the economic fundamentals allowed to. 1970 was also the last year of the Diaz Ordaz administration, which by definition meant increased public spending; thus, total GDP grew 6.9 per cent. Nevertheless, red numbers were already outweighing high growth: inflation jumped to 6 per cent (it doubled in one year) and the trade deficit peaked at 1,210 million dollars, while public deficit went from 2.2 per cent of GDP in 1969 to 3.8 per cent in 1970 (Cardenas, 1994:93). Total debt amounted slightly more than 9 per cent of GDP (BMYR, 1970) and amortizations had jumped to 2.4 per cent of GDP, or more than a quarter of the total value of exports. All these threats should have been enough to take corrective measures, but a new president - Luis Echeverría- was about to take office.

3.4-The seventies: the beginning of the end; petrodollars and economic populism.

The structural weaknesses which were noticeable by the end of the sixties became, in fact, a crisis in 1976 with the first devaluation in 22 years and again in 1982 with the country's declaration of moratorium and second devaluation. High inflation and excessive borrowing would only become worse. However, the sudden discovery of vast oil reserves by the end of the decade completely changed the economic dynamic. In the short run, revenue windfalls did enhance growth, but the substantial increase in borrowing –justified in terms of the need of investment in the oil industry- would prove disastrous in the years to come.

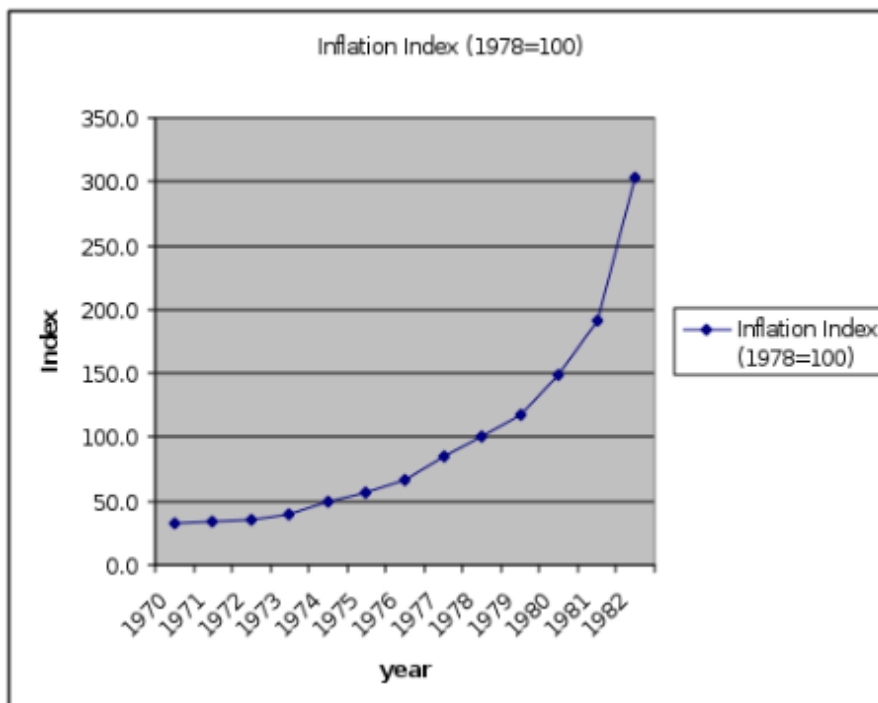
In fact, GDP growth averaged 6.7 per cent during the seventies, while GDP per capita increased by 3.7 (see figure 12). By 1981, product per capita amounted to 7,623 international dollars, from 5,108 ten years earlier (Penn tables). However, inflation averaged 17.9 per cent and the fiscal deficit went from 2.5 per cent of GDP in 1971 to 14.1 per cent in 1981. Foreign debt, which at the start of the period was of 8,630 million dollars, reached 74,350 million ten years later, and right before the moratorium in 1982 it peaked at 92,410 million dollars (Cardenas, 1996:89) Furthermore, as shown in tables 9 and 10, current account deficit peaked at 6 per cent of the GDP in 1981. Despite the share of exports over GDP increased somewhat, it is clear from table 10 that dependency upon oil –measured as the oil share in exports- had become unsustainable: from virtually zero in 1973, to 53.1 in 1981.

Figure 12



Source: Penn tables

Figure 13



Source: EHM (1994)

Table 9

Year	Imports	Exports	Balance, MD
1970	2 500.5	1 289.6	-1 210.9
1971	2 423.6	1 365.6	-1 058.0
1972	2 963.7	1 666.4	-1 297.3
1973	4 165.7	2 071.7	-2 094.0
1974	6 545.1	2 853.2	-3 691.9
1975	7 128.8	3 062.4	-4 066.4
1976	6 679.7	3 655.5	-3 024.2
1977	6 022.5	4 649.8	-1 372.7
1978	8 336.5	6 063.1	-2 273.4
1979	11 979.7	8 817.7	-3 162.0
1980	18 832.3	15 134.0	-3 698.3
1981	23 929.6	19 419.6	-4 510.0
1982	17 010.6	24 055.2	7 044.6

Source: EHM (1994)

Table 10

Year	Total exports/GDP	Oil exports/total exp.	total imports, %GDP	Current acc. Deficit, %GDP
1970	7.7	0.3	9.7	3
1971	7.6	0.1	8.7	0.2
1972	8.1	0.1	8.8	1.9
1973	8.4	0	9.5	2.4
1974	8.4	0.4	10.6	3.7
1975	6.9	7.2	9.6	4.2
1976	8.5	7.2	9.9	3.3
1977	10.3	11.7	10.2	2
1978	10.5	16.5	11	2.6
1979	11.2	25	12.5	3.6
1980	10.7	47.5	13	5
1981	10.4	53.1	12.9	6
1982	15.3	62.7	10.3	0.5

Source: Banxico, indicadores economicos 1970-79.

As pointed out by Bazdresch and Levy (1991), the political context does help to understand growth in general and populist economic policies in particular: Echeverría took office only two years after the 1968 brutal repression of the student movement. The regime faced, for the first time in decades, a real crisis. Legitimacy had to be restored; thus, the new Echeverría administration badly needed growth to continue.

Another important element was the recruitment of economists from the UNAM (the National University), sympathetic to an interventionist state and widely influential with the President. In truth, the ambiguity of the means for achieving goals that no one would oppose in principle (growth and equality) was part of the “Shared Development” strategy: the state, by virtue of being the state, knew best. As explained by Levy: “with the benefit of hindsight, what Echeverría had in mind appears clear: that economic policy should henceforth obey the rules of the government, not those of the private sector” (Bazdresch and Levy, 1991:238)

As mentioned above, 1971 was a year by which growth slowed down, sending worrying signals to the government. By the next year, the growth-at-any-price strategy became evident: in spite of an increase in revenues of only 10 per cent, government expenditures grew 22.9 per cent (BMYR, 1972:26).

The spending fuelled growth again, as GDP increased 4.9 per cent in 1973 alone. On the other hand, it fuelled inflation: from 5 per cent in 1972, to 12 and 23.8 per cent in 1973 and 1974, respectively. In 1973, another crucial shift took place; the source of external borrowing shifted from multilateral institutions –that would offer more stable interest rates- to private banks, therefore facing shorter maturities and higher and more volatile interest rates. As to borrowing as a whole, the BANXICO 1973 annual report states that dollar-denominated liabilities grew 42.9 per cent in that year alone, in contrast to a growth of 8.8 per cent in peso-denominated liabilities (BMYR,1973:53). Consequently, it was not only about the quantity of borrowing but also its composition what made it a real threat. It didn’t help, either, that the 1973 oil shock intensified attempts from banks to find outlets for the large petrodollars deposits (Levy and Bazdresch, 1991:239)

The trade deficit was also worsening at a worrying pace: from 1,200 million dollar in 1972, to 2,000 million in 1973 and 3,600 in 1974 (see table 9; EHM) mostly the result

of fixed exchange rate, high investment rate and access to capital. Instead of devaluing the peso, the government tried, unsuccessfully, to solve a macroeconomic problem with more trade controls. The proportion of licensed imports, which was already 68.3 per cent of the total in 1970, would peak to almost 80 per cent by 1980. By 1974 it was clear that foreign borrowing and inflationary finance were feeding themselves. The private sector had already noticed this and, with negative real interest rates and expecting devaluation soon, there was substantial capital flight. This is also clear from the figures on private investment: it grew only 2 percentage points in 1975, whereas public investment increased 21 per cent (Bazdresch and Levy, 1991:243).

The government was aware of the acute situation and announced a “stabilisation programme” that had limited effect. Even the central bank’s report, usually temperate in its language, pointed out to excesses from the government, by stating that “It had been expected an only moderate increase in government spending, as well as a correction of public finances and a more efficient way of spending” (BMYR,1976:21). However, such corrections never took place.

The reasons were not technical but all too political. Echeverría did not want to stabilise the economy, as this would have meant reversing the policies which won him over powerful political constituencies. But the figures speak for themselves: foreign debt was increased almost 100 per cent only between 1974 and 1976. As Levy describes it: “(...) the process came to a halt in September 1976, when the exchange rate, which had been nominally fixed since 1954, was devalued by 59 per cent. Faced with no alternatives, with depleted reserves, with inflation of 22 per cent, a foreign debt of \$29.5 billion dollars and a rather strained relation with the private sector, the Echeverría administration terminated with an agreement with the International Monetary Fund (IMF). (Bazdresch and Levy, 1991:246)

President Lopez Portillo took office amid one of the worst crises the country had even faced: rampant inflation, capital flight, fiscal deficit and, in addition, a sour relation with the private sector. So his immediate efforts were about reconciliation with business and cutting spending; he was somewhat more successful in the former. Nevertheless, by 1977 GDP growth slowed down to 3.7 per cent, just above population growth, as a result of decreased investment. As part of the agreement

with the IMF, the government committed itself to start dismantling the import-licensing system as it had reached 100 per cent of imports by 1976. However, the process would be reversed a couple of years later.

The year of 1978 substantially changed the course of events. Proven oil reserves ballooned from 16,000 trillion barrels to 40,194, 45,803 and 60,126 in 1978, 1979 and 1980 respectively (Ortiz, 1985:73). This radically altered the government's room for manoeuvre, as oil reserves improved credit ratings and therefore access to borrowing. In fact, Lopez Portillo's rhetoric after the oil discoveries was that of "financial self-sufficiency" and that of a public sector able to produce its own inputs to avoid "blackmailing" (capital flights) from the private sector (Bazdresch and Levy, 1991:249).

The economic expansion triggered by the oil was indeed spectacular: 7.8 per cent average GDP growth between 1978 and 1981, while inflation averaged 24.2 per cent (BMYR, 1982:83). The private sector's response was to increase investment by 22.7 per cent in 1979. The oil shock of that year brought excessive optimism to the country, to the extent that the president himself declared that the challenge was how to "administer the abundance".

Rather unfortunately, such abundance was mis-managed. The current account deficit went from 2.7 billion in 1978 to 16 billion in 1981, a six-fold increase (Ibid, 1991:249). This, coupled with a public spending in the magnitude of 40 per cent of GDP in 1981 ended with yet more borrowing: debt peaked at 74.4 billion dollars that year (BMYR, 1982) In addition, import controls were re-instated.

If President Lopez Portillo tried to avoid the tragic end of Echeverría's *sexenio*, his own experience was even worse: early 1982 saw a devaluation of 470 per cent, a decline of .5 per cent in GDP, a public sector deficit of 18 per cent of GDP and a debt of 92.4 billion dollars. Thus, by 1982 the oil boom ended in a nightmare, and the whole strategy of inward-oriented growth offered no prospects at all.

3.5.- Conclusions

Prebisch's remark (see the epigraph) pointing out the paradox of ISI in the sense of even greater, not less "external vulnerability", has been shown as correct in the Mexican case. The secular tendency of imports to outpace exports, as shown in tables 4 and 9, could only be compensated with the invisible components of the capital account –for the most part beyond the scope of government policy.

Evidently, the lack of a strong, dynamic export sector was a secular problem: albeit diversified in terms of commodities, exports were chiefly low value-added and too dependent on the US market. This is, in turn, related to the stagnation of the agricultural sector: the lack of investment, price controls, the divide between small, subsistence yet numerous producers and few exporters meant that the sector as a whole never reached the dynamism it could have offered.

As for the self-imposed goals of ISI in Mexico, it is clear that substitution of consumer goods was successful, but its gains were cancelled out by ever-increasing imports of capital goods, intermediate goods and raw materials. In fact, between WWII and 1960, imports grew faster than income (Villareal, 1974:154). The strategy did bring structural transformation, but dependency over imports was, if anything shifted towards capital and intermediate goods.

On the structure of trade protection, even if overall it was lower than in other Latin American countries –Chile and Brazil- in the case of the manufacturing it was substantially higher –and both in nominal and effective terms. Some sectors had staggeringly high effective protection rates, such as durable consumer goods, with 129 per cent, food and beverages that peaked at 257.8 per cent (Bueno, 1971).

In sum, the import licensing mechanism has to be understood in the context of a trade policy that was in turn shaped by either industrial policy –at best- or by the reluctance of the government to solve current account crises with devaluation.

4 -CHAPTER THREE

QUALITATIVE EVIDENCE ON RENTS, RENT-SEEKING AND RENT-EXTRACTION

ABSTRACT: The aim of this chapter is to present, describe and analyse the qualitative evidence for rents and the efforts to secure them. Albeit limited in their scope, the documents revised here offer examples of the arbitrariness in trade policy in general and import-licensing in particular: that is, cronyism. Those politically connected would either block competing imports –accruing monopoly rents- or be granted import permits, thus giving them an artificial cost-advantage over competitors –“Rising-Rivals’-Costs” strategy. On the other hand, it is shown how excessive trade restrictions created perverse incentives for smuggling and rent-extraction at the customs.

4.1- INTRODUCTION

The aim of this chapter is to present, describe and analyse the available qualitative evidence for rents and for the efforts to secure them. Strictly speaking, the evidence is patchy, incomplete and of heterogeneous quality; it does not cover whole economic sectors or long periods of time due to inherent limitations in the materials available in AGN. Yet, it is a highly valuable set of primary evidence that had never been analysed. As such, the materials provide a window into rent-seeking activities during the fifties, which is a period of “transition” for ISI in Mexico; that is, when serious efforts were directed towards the substitution of intermediate and final goods. It is the “deepening” or “vertical” substitution period that coincides with unprecedented growth of both the economy and the state. Roughly, the evidence covers two *sexenios* that of Adolfo Ruiz Cortines (ARC) from 1952 to 1958 and Adolfo López Mateos’s (ALM) from 1958 to 1964.

At any rate, by the late fifties the substitution of simple, cheap consumer goods had been completed. By some econometric measures, (see, Villareal:1970) 1958 represents an structural break in terms of the income-elasticity of demand for imports, since it was only after that year that such measure was lower than one. The establishment of new industrial projects meant less imports of finished goods, but more of intermediate and, especially, capital goods. In this context, trade policy

became more relevant than ever: import licensing, albeit at first justified by deficit worries, became the preferred way of granting protection. However, its repercussions became more difficult to handle, as granting protection to producers of inputs (not only to final products) often meant rising costs for all domestic producers. Thus, privileged access to government officials or the ability to influence, bribe or blackmail the government concerning import access/control could make a crucial difference.

The documents can be classified as follows: i) letters submitted by private firms asking for tariff protection and/or qualitative controls, ii) requests for import permits for inputs ii) internal documents from the SIC assessing specific cases and requests, and iii) letters from officials who, for various reasons, wanted to disclose information about sensitive cases.

All documents were gathered in the National Archives in Mexico city, mainly from two core sub-sets: the Presidential archives and correspondence (which include ARC and Miguel Aleman Valdes, MAV) and SIC records contained in the "*Fondo 217*" which comprises all the materials available on trade policy. Unfortunately, the Sub-secretary of commerce (where the import-licenses were actually produced) is missing from "*Fondo 217*", which means that documents available on trade policy are so because there was some sort of overlap with industrial policy.

The set covers 9 industries, plus the case about the Acapulco Custom. This set has the advantage of heterogeneity: there are agricultural products, simple and intermediate manufactures, industrial inputs and automobile industry. Thus, it is possible to show the complexity of the import-controlling system and, moreover, the opportunities for rent-seeking. It should be noted that these were most complete cases found after an exhaustive revision of the archival materials, so it clear to the author that many documents were either lost or destroyed. In that sense, the absence of industries of obvious relevance should be interpreted as a direct result of data/material constraints rather than conscious exclusions.

The theoretical framework

As it was explained at length –see chapter one- the theoretical foundations of the rent-seeking framework are based in the works of Tullock (1967), Stilger (1975) Krueger (1974), MacChesney (1989) and others. Following Krueger, the starting point about the import licenses is that, under trade restrictions, they become a “valuable commodity”. It should be noted, though, that not only Krueger but many others point out that rent-seeking should be understood as a continuum that includes both legal activities –mostly *rent-creation*- and illegal or paralegal –mostly, but not, only, *rent-extraction*.

Translated into a particular methodological framework to deal with both the licenses in particular and trade restrictions in general –that is, the rents accruing from them- the three following categories are used:

Monopoly rents: that is, import-licensing (along with tariffs) used as a device to create artificial scarcities by getting rid of foreign competition; a captive market for one or few firms. Conceptually, what matters here is that rents are accrued at the expense of consumers and that they are the indirect outcome of licensing, as opposed to those who actually exercise the right to import banned items.

Rising-Rivals’-Costs Rents: in this case, import-licensing is used to get an artificial advantage vis-a-vis other firms within the same industry: prices need not to be raised, as the firm’s costs will be kept lower than those of its competitors. That is, rents at the expense of other firms

“Money-for-nothing” rents: these are payments often exacted as plain extortion or blackmail: can take the sophisticate forms of threats to reverse particular policies or measures or the straightforward form of asking money *not to* retain goods at the customs even though all the legal requirements have been met: it is literally *money for nothing*.

This categorisation stems –as explained in the Literature Review- from the neo-classical or orthodox approach to rent seeking which admits no positive role for rents in the economy. Hence, in order to reflect the heterodox approach (informed mostly by the experience of South East Asia) the concept of *Learning Rents* as defined by Khan and Jomo (2000) will also be used while analysing the evidence. In other words,

not to rule out the possibility that, at least in some cases, the government was able to use temporary rents as an incentive to invest in technology-intensive projects.

Lastly, a cautionary word on the presentation of primary evidence: given the lengthy nature of the citations for the documents as classified by the National Archives, it was decided by the author to provide full citations in footnotes (as well as the Sources & Bibliography) while references to secondary sources are kept in line with the Harvard style.

4.2- Monopoly Rents

4.2.1 The Fruit Trade

Albeit representing a small share of imports, and not being a manufacturing industry, this case is presented first because it is apparently “harmless” protection given to nascent business at the very early stage of the licensing –among the monopoly rents category, it is the one that happened first. However, that does not imply that the rest follow a strictly chronological order.

The year 1947 saw the formal implementation of quantitative restrictions to trade - via import licenses-. The government had initially signalled that such barriers would apply only to “luxury items” as those were responsible for the out-of-control trade deficit. In any case, the timing was indeed convenient for the government as that year the special trade agreement with the US -set up during the war- was meant to expire, and despite the interests of US exports, the Mexican government had no intention whatsoever of renewing it.

Seen as a strait-jacket on the economy by Mexican officials, the termination of the agreement gave them room to manoeuvre. Tariffs were raised almost immediately, and luxury items were far from being the only ones directly controlled with licenses. This raised concerns amongst US exporters, who by the early fifties were witnessing an unequivocal shift toward heavy protectionism. By their part, Mexican businessmen did not hide their distrust for free-trade, as it was noted by the biggest private bank’s assembly in 1947.

A case in point is the apples and pears business. Affected by trade restrictions, the largest US exporter of these fruits sent a letter directly to the President (which, in

itself shows how concentrated policy-making was by the time). The letter -and the internal follow-ups- raises two important issues; namely, not only the unfair advantage given to local producers -that were after higher prices for their produce- but the smuggling that restriction creates along the border. That is, both legal and illegal rents.

The firm involved is Northwest Horticultural Council, located in Yakima, Washington. It is dated October 8, 1953 and signed by the manager, Ernest Falk. Four paragraphs of the letter speak by themselves:

Apples and pears grown in Washington and Oregon are in great demand in Mexico. To harvest the fruit we must have seasonal agricultural labour. A large number of Mexican nationals have been made available for and used in agricultural labour in Washington and Oregon through the agreements between your government and ours. (...) We are vitally interested in exporting apples and pears to Mexico. During the 1945, 1946 and 1947 seasons, we annually exported to your country approximately 225,000 boxes of apples and 35,000 boxes of pears. This volume was sharply reduced in 1948 when, we understand, artificial barriers were erected by the Mexican government and importation of fruits either prohibited or sharply restricted through the granting of licenses.

At the time same time, members of our trade noticed a diversion from firms previously in the import business to newcomers. We also note that the volume of exports as reported in the import business by the United States Office of Foreign Agricultural Relations was substantially greater than the volume reported by the Department of commerce which is based its reports on your Government's import figures.

We are informed that, during this period, the Trade Agreement between the United States and Mexico expired and was not renewed. Mexican import duties on apples and pears were four to five times higher in 1952 than they were in 1947. The import duty was changed from a fixed amount per gross kilo to a higher fixed amount plus an ad valorem duty. We wonder whether this change, along with the restriction of permits, may have been intended for the purpose of driving legitimate importers out of the deal and permitting those on the inside to obtain supplies at a much lower cost by smuggling them across the border. This could account for the variation between our Government's export figures and your Government's import figures.

We respectfully request, Mr. President, that you institute an investigation and examination of this situation. We urge that your Government consider reducing your import duties on apples, pears and other deciduous fruits to the

1947 levels, and the removal of restrictions on import permits so that trade in a greatly increased volume can again flow through the normal, legitimate channels. Such increased trade would be to our mutual benefit. It would afford our growers an additional outlet and would afford your citizens our very desirable products at a more reasonable cost.⁴

Not surprisingly, Mexican businesses were also lobbying the Presidential Office to precisely block imports as much as possible. Two documents prove they asked for and succeeded at it. First, a letter sent on December 8th, 1954 from the Regional Association of Apple Producers in Chihuahua (the biggest Apple producer) formally asked the inclusion of apples in the “banned imports” list: “It is asked to stop permits for importation of apples, as it harms domestic producers’ interests and the internal economy”⁵. In a rather speedy fashion for Mexican Government’s standards, it took five days to approve the measure, not enough time to comply with the requirement of a technical assessment by the SIC.

A signed and stamped letter sent to the President by the Ministry of Agriculture gives account of the approval:

“As per instructions by the Secretary of the Ministry of Agriculture, concerning your letter num. 36009 -copies of which were received by Jose Almeida, Otilio Mariscal and the rest of the members of the Regional Association of Apple producers- I am pleased to inform you that import permits for [all] fruits have been cancelled”⁶

It has to be noted that a different set of documents⁷ -not related to this case- sent by Mr. Otilio Mariscal show that he held a position in the PRI local office in Chihuahua as liaison with the CNC - the supposedly “union” for peasants, though in practice it is widely acknowledged it was yet another ad-hoc state organization to co-opt potential destabilizing groups, just as the CTM -the “workers’ union”- was used to control labour in Industry at large.

At any rate, the fact that Falk’s letter was never replied (it is possible to infer this from the way correspondence was archived: no stamp of “dealt with” or copy of

⁴ Letter sent to the Office of the President, number 36336, classified as ARC: 998/564.2/347

⁵ Ibid

⁶ Document 101.8978; classified under same set: 217/564.2/347

⁷ 217/564.2/358

reply, as it was the norm) and that local producers' demand was met in just a few days makes the case for a biased response very likely.

The case is even stronger if two further elements are taken into consideration: first, the lack of economic rationale for such measure and, second, the divergence between the US exports statistics and the Mexican imports figures. Although it is somewhat problematic to use this method, at least in the case of fruit and few other items it is clear that a substantial share was crossing the border without it being reported.

Regarding the lack of economic rationale, in turn, there are several reasons backing this claim. To start with, not even apples by themselves but "fruit" in general was a negligible component in the trade balance accounts -less than 10 per cent of the value of corn imported before the devaluation of 1954. Neither was it a luxury item seen as "superfluous". So banning apples in order to save foreign currency was hardly defensible. Moreover, the index for food prices -210 basic consumption items- in Mexico City had been augmenting even before the Korean War -which had an overall inflationary effect. Foodstuffs increased their prices 13.4% in 1954 alone (BANXICO, 1955:20) whereas the fruit component increased 13.4 per cent. (Ibid) This may have partly been caused by the import-tightening in itself, as tariffs were not raised at once but gradually. So products costing less if imported would help keep the cost of living low. Even accounting for the 1954 devaluation, American apples were significantly cheaper than Mexican ones: roughly 42 per cent.

The central bank, on its 1955 report, acknowledged that in the context of the devaluation -from 8 pesos to 12.50 per dollar- trade restrictions would have even a faster effect upon the deficit, but clearly states that items controlled were only those luxurious. On the other hand, there are discrepancies as to the value of fruit imports.

4.2.2- Poultry Industry

The poultry industry also offers an archetypical case of redundant protection, strongly suggesting successful rent-seeking. By the late forties, the government had imposed a high tariff on the importation of live chicken (to be fed in farms for both meat and egg production). However, local producers quickly adjusted prices upward,

thus accruing rents from protection. As a result, production of both poultry meat and egg stagnated and even declined, during a period of high population growth which makes it all the more harmful. By the time this was evident in price increases of the final products; the Ministry of the Economy in fact back-pedalled and lowered tariffs for live poultry. Evidently, the government could not afford to have unnecessarily expensive food staples: it has been shown elsewhere that a maintaining a low cost of living for urban workers was a core economic policy, as well as a core demand from the private sector in general and industrialists in particular (King,1970; Cardenas, 1990).

A letter⁸ from the National Federation of small poultry producers (*Federación Nacional de la pequeña propiedad ganadera*) exposes this and warns the ministry about renewed efforts to raise tariffs again.

“With due respect, I address you on behalf of the National Federation of Small Farmers (NFSF). Please allow me to draw your attention toward the grave threat the poultry industry is facing nowadays; this, as a consequence of the manoeuvring pursued by a small monopoly group aimed at blocking the importation of baby chicks already approved by the National Poultry Improvement Plan. This move would strip local producers and farmers of this crucial supply, especially taking into account that domestic production (of chicks) can meet only 20% of demand from poultry and egg producers.

For the aforementioned reasons, this organization and its members support the national Poultry Association, which is alarmed by the possibility of the government imposing an incredibly high tariff for baby chicks, especially in a context of excessive demand and rachitic supply; this would only raise costs for producers. You, Mr. President, with your deep revolutionary sensibility and unblemished patriotism, have set the goal of improving people’s diet and thus rising living standards. These circumstances push the NFSF to kindly ask for your intervention as to avoid the decline of the domestic poultry industry”

Another letter, two years later, from Rancho “La Providencia” (dated the 19th of April, 1955) a medium sized producer, complains about the never-ending problem of smuggling in the border. This case goes beyond the problem of successful rent-

⁸ ARC: Vol. 564.2/109

seeking through trade restrictions as it points out illegal activity; namely, sub-standard egg being imported under the free zones regulation and then sold in Mexican markets with obvious artificial cost-advantages vis-a-vis the local product – and serious consequences for public health.

“As a matter of fact, egg and death poultry animals from the US cross the border exempted from specific and ad-valorem tariffs, given the Free Zones (FZ) regulations. Even worse, that happens without the merchandise being inspected as to meet neither sanitary nor custom standards. These anomalies are amply used by traders and ruthless merchants, who buy the product at negligible prices (outside the regular channels) because the US government forbids its sale, but does not oppose its exportation (to Mexico). These imports take place in the custom of Tijuana, Tecate and Mexicali, and the egg is sold as if it were fresh produce, causing serious illnesses –especially amongst children. Furthermore, the lack of proper enforcement of custom procedures allows for boxes of eggs to be used to smuggle liquors and other restricted items into de country”⁹

The letter goes even further and reports apparent malpractices amongst the distributors of US products in northern Mexico, who refuse to buy domestically produced egg, giving all sorts of excuses. Even if they buy locally –the claim goes– they intentionally delay the payments as to force business to go bankrupt and thus get a higher market share. The letter emphasises the fact that the value of imports of both egg and poultry in 1954 alone was \$1,482,720 USD, an increase of almost 20% relative to the previous years. Moreover, poultry feed products require an import license (in a committee at which the Ministry of Agriculture is represented)

The sender considered this as a contradiction since there was no local production of this product, and notes that on a cost basis they (poultry producers) will never be able to compete with the American firms. The specific requests are in line with this: i) to apply custom and sanitary regulations to all egg and poultry imports, and ii) to impose tariffs on such imports.

⁹ ARC: Vol. 564.2/111

4.2.3- Gloves Industry

Gloves fall into the category of simple manufactures and its weight in the economy as whole was negligible. Yet, this is another case that shows the discretionary nature of officials' decisions, first, and second, the relative easiness with which incumbent firms could influence policy, even without "special access".

By 1957, the market for gloves, according to an internal document¹⁰ was dominated by two firms: "Teck de Mexico" and "Guantes Industriales Guadalupe", the former produced 624,000 pairs that year, whereas the latter produced 1,872,000. In total, domestic production went from 1,144,000 pairs (in 1957) to 3,432,000 the following year, whereas imports amounted to 5,920 pairs in 1958 –obviously a negligible figure that makes the case for licensing rather weak.

That is why the first document is clear in that respect: "Concretely, it is considered unnecessary to establish the requested import controls (for gloves) given that such measure would mean an increase in red-tape and, moreover, a gradual increase in prices, being both outcomes unjustified given the state of the market for such products."¹¹

However, producers knew that importers could take advantage of the lack of enough tariff classifications to bring into the country plastic gloves. In the end, their fears were addressed and the Ministry back-pedalled on its decision:

"In memorandum sent on the 25th of April, it was considered as premature (establishing import controls to gloves, as requested by producers) given that demand is met almost entirely by domestic production, which leaves imports as mostly harmless to such producers.

The Chamber, in its letter of the 7th of June, supports this request and argues that it has to be considered that control for latex gloves is already in place, thus, if plastic gloves are not also subject to control there will be a shift in demand from one type to another. Therefore, the two sorts should be subject to control. This secretary considers this argument as valid: in consequence, the previous memorandum will be cancelled."¹²

¹⁰ ALM: 557 20/511.01/727 exp. 13

¹¹ Ibid

¹² Ibid

This is also telling about the role of business chambers –in this particular case, the CANACINTRA, which would represent virtually all of the new industrialists. Clearly, had it not been for the pressure of CANACINTRA, the Ministry would have maintained its decision of not protecting the gloves industry.

4.2.4- Linoleum Industry

This case is documented in a set of documents comprising two letters sent by the firm Ger-Mex asking for protection, an internal document summarizing the data sent by the firm and two drafts of the official answer –plus the official response, signed. Interestingly enough, the final version differs from the draft in important ways, as it will be shown. The annexes attached by the firm provide detailed data on costs, sales and profits, which will be reproduced here and used to weigh the size of rents to be accrued from trade protection.

The summary¹³ prepared for the Ministry of the economy starts with the specific request: to impose tariffs –both nominal and ad-valorem– to three tariff classifications (which are numbered as 648.03.00, 648.00.301 and 648.03.02) whereas the firm commits itself to keep a price of \$33.50 pesos per square meter, as long as "circumstances determining cost and administrative costs remain the same. If those were to change, they would ask permission for raising prices" (Ibid). The firm also acknowledges that its quality standards will be revised periodically, and that it will adhere to any measure dictated by this Department. Interestingly, this is clearly signalling learning rents, assuming of course that the SIC would keep monitoring and that it would be able to cancel the protection if necessary.

Fraction 648.03.00 covers decorated cork sheets, reinforced with any kind of organic fibre, including linoleum, not used in furniture or vehicles. The official price for importing them is \$6.25 per kilo, to which a tariff of 0.70 pesos (specific) and an ad-valorem of 80% apply. It is subject to rule XVI, which requires product identification. Its importation moved from 708,258 kilos in 1954 to 316,421 kilos in 1954, that is 55% less in volume and 23% less in value. With no known domestic production yet,

¹³ 217: Vol.,557., Exp.13

the report notes, the first one to do so would be in position to compete with imports, since the \$0.70 pesos per kilo and the 80% specific and ad-valorem tariff, respectively, are high enough.

Fraction 648.03.01 refers to cork sheets used in furniture and vehicles. It is not subject to rule XVI, but does have a specific tariff of \$0.15 pesos per kilo and an ad-valorem of 25%. Official importation price is \$7.00 pesos. Its importation has fallen 57.3% on a volume basis and 39.3% on a value basis (from 1954 to 1958) this time precisely because increased domestic production.

Fraction 648.0302 includes carpets and sheets made of cardboard; cardboard sheets covered with synthetic resins. Official price is \$4.30 pesos per kilo, with specific tariff of \$0.70 and the ad-valorem at 55%. Imports -registered only since 1956- had gone up 87% (value). As in the first case, there was no known domestic production and the protection -\$0.70 specific and 55% ad-valorem- was considered as high.

Ger-Mex had been established the previous year and its production was limited to 648.03.01 (artificial linoleum). The report notes that the firm praises itself as offering a product whose quality was superior to that of imports. They quote the answer letter from its biggest client, "DM Nacional":

"We've done exhaustive tests to the plastic materials offered by you as substitute for the German linoleum we've been importing at \$33.50 per square meter. We find this material adequate to all our needs. Therefore, we have instructed our supplies office to buy this material from you. We are positive that further deliveries of the product will be of better quality, just as you've offered".¹⁴

The report also notes that 38.5 % of raw materials consumed by the firms are imports and the 61.5% left is of domestic origin. The total number of employees is 32. The entire production is bought by two companies: DM Nacional and H. Steele y Cia., which together imported 321,822 kilos in 1958. At a production rate of 700 kilos per day, the firm was able to cover the latter quantity in slightly more than a year. The quoted price for the import is \$34.50 pesos per kilo, which is one peso above the domestic substitute.

¹⁴ 217: Vol.,557., Exp.13

The report's conclusion note that Ger-Mex is explicitly asking for protection on two tariff categories that are not relevant for what it produces, which could be inexplicable at first sight but then adds: "however, these fractions having high specific and ad-valorem tariffs, implicitly protect its product and close substitutes already produced in the country, as it gives a price advantage over foreign linoleum."¹⁵ Despite this acknowledgment, the Ministry of the Economy agrees not only to raise tariff protection on all three fractions, as to leave the specific tariff at \$0.70 pesos per kilo, plus the additional ad-valorem at 80 per cent, which is in fact high even factoring for tariffs on inputs (effective protection) but also to declare these items as of subject to import licensing. The reasons given are straightforward: the "national" character of the firm, plus the fact that price is lower than imports and quality good enough.

What makes the case more interesting is the contrast with the draft, whose conclusions are divergent in not minor ways. The draft, apparently written by the staff and revised by the Secretary, does warn that the firm has a dominant market position and it is likely to abuse it. Strikingly, it still advocates for protection, although not as high as the final document: "Given the monopolistic character of this firm, and the likeliness of price increases soon, we advise increasing the quotas as long as the firm commits (to keep the same prices)". Instead of 80 per cent ad valorem, the draft suggests 60 per cent ad valorem -still high enough.

In addition to the tariff protection, the requirement of a license to import all three products was decreed, which means that at any rate the domestic market was sealed up in favour of Ger-Mex.

¹⁵ Ibid

4.2.5-Tin Industry

The relevance of this case stems from the fact that it was not only a heavy industry but also because demand for tin soared as import substitution went further. This is especially true taking into account that by the late fifties the state-owned steel and metal company “Altos Hornos” was fully operational, accounting for a significant proportion of demand: 30% in 1958, according to the Ministry’s own reports (see below). In addition, plants manufacturing electric devices were also establishing by the time –General Electric and Westinghouse being the bigger ones-.

The account of this case is provided by a set of six documents; two are internal papers providing data and information about the industry, whereas the other four are letters sent by and to the three incumbent firms and the SIC. The case is somewhat complex, but the letters show how in a context of rapid demand growth, the tin oligopoly tried to maintain the domestic market closed to imports and thus take advantage of the worsening scarcity of tin. On the other hand, it also shows a relatively common practice in the metal and mineral industries, namely, saving on the processing by “temporarily” exporting the minerals and then re-importing the metal plates. In this context, the potential sources of rents are numerous: i) first and foremost, by banning all tin imports while demand for it increases, effectively charging monopoly prices, ii) by blocking all attempts to temporarily export the minerals, thus charging higher price for the processing, iii) by getting a sole permit to export and/or import, which would mean that even selling at the same price profits would be higher as costs were substantially lower (in this particular case it’s about the RRC model).

From the Ministry’s report it is possible to establish some facts about the tin industry. First, domestic supply was not growing fast enough, therefore imports had to compensate for it; tellingly, exports had completely halted by 1958 as a result of the soaring internal demand. As the letters show (see below), this context made the licensing of tin imports all the more relevant, since blocking them would secure monopoly rents to producers.

Table 1

Tin production, 1953-58 (source: exp. 511.01/-721)				
	Domestic supply	Imports	Exports	Domestic demand
1953	483	117	54	546
1954	355	417	8	764
1955	615	472	114	973
1956	508	470	3	975
1957	481	527	3	1005
1958	552	765		1317

Source: 217: 554, Vol., 511.01/727, Exp., 7.

The market was *per se* oligopolistic: there were only three firms producing tin plates: Minero-Metalurgica de Estano (MME), Estano-Electra (EE) and Compania Estagnera Mexicana (CEM). Furthermore, only EE had the capacity to fully process the tin (that is, extraction, melting and casting). The other two were not able to cast tin plates, and their production was carried with “antiquate means” according to the report.

On the other side, demand came from 8 firms and five industries: Altos Hornos, La Consolidada, La modelo, General Electric, Westinghouse, Mata y Gonzalez, German Sommer, Gustavo Sommer, Telmex. The relevant industries were newspapers, prints, Pharmaceutical labs, Tobacco firms, chocolate makers and car manufacturers. By 1959, tariffs were \$0.15 pesos per kilo and ad-valorem of 15 per cent (official price was 30 pesos per kilo).

This first report notes the advantages exporting firms were given with export permits; this, made evident by the fact that all had opted to temporarily export the mineral rather than buying the services from local firms. In a first attempt to support domestic industry, the Ministry tried to force those firms to do business with their partners:

“Current Import controls allow for total domestic production of tin to be sold, as well as to allow consumers to import if they need more, depending on their needs. (thus) Tax exemption to exporters of tin minerals (than re-import the processed tin) should be changed as there is a plant capable of producing tin with a 99.9% grade.

Refusals to temporarily export tin minerals are based on the fact that one firm –Estaño-Electrica, S.A. de C.V- is willing to lower its prices as long as the exporters commit themselves to supply at least five tons of minerals per month. The frequency with which requests for temporary exportation of tin are submitted tells us about the apparent ignorance about the

existence of this firm. Once asked directly, would-be exporters claim that EE asks for prices all too high. Exporters' insistence suggests it might be the case that they would export low-grade minerals only to re-import (cheaper) tin, thus taking advantage of its scarcity in the country.

Given these reasons, it is considered to be right to deny temporary export permits, on the one hand, and to plan a general meeting with both exporters and processors as to achieve an understanding between the two sides"¹⁶

The Second document available is a letter¹⁷ addressed to *Departamento de Fomento*, dated October 29th, 1959 and sent from Cia. Estañera Mexicana (CEM) which was the first one in the country. It does give an account of rents recently secured and the threat import licenses did pose to them.

It starts giving some context, and noting that international prices had gone down in 1958 and had only recently recovered to its previous level of \$1.03 dollars per pound. The domestic market had followed a similar upward pattern, although for different reasons: new production lines using up more tin plates and a shortage of the mineral. In turn, the scarcity commanding higher prices was attracting more investment and production, precisely what CEM was doing. Interestingly, they note that expanding production was only possible after having found "finally, capable functionaries whose vision, backing and help have been crucial; above all, the *stabilization of the domestic price*" (Ibid, emphasis added). In other words, they would not invest without knowing that profitability was going to be maintained.

Next, the document remarks the goals the firm will help to achieve: i) development of a new source of wealth, not exposed to external fluctuations, ii) saving foreign currency, thus helping reducing the deficit in the current account, iii) jobs in the primary sector and the industry and iv) the ability to produce what the country consumes.

Having set the stage, CEM then raises the issue of recent importation of tin, and then goes on plain blackmailing, openly blaming the government policies for job layouts:

"We will find ourselves -just as other firms in the industry- in the need of halting production and get import permits as well -which could not be denied- to meet demand from our clients.

¹⁶ 217: 554, Vol., 511.01/727, Exp., 7

¹⁷ Ibid

Thus, not only casting will be suppressed but jobs as well (...) miners will again abandon their work, to which they won't come back because of having been despised, so they will migrate or face an increased poverty. We, that have fought to give Mexico a new industry, will completely lose our morale and money invested. In sum, this newly born industry will die."

The threat of job layouts would in fact become part of the discourse amongst businessmen. This has been pointed out in seminal works on Mexican Industrialisation (Rubio, 1990:249)

At any rate, it is clear that the stakes were high for CEM. The firm was aware of the steady increase in domestic demand for tin, which couldn't possibly be met with local production; however, their profits were inversely proportional to the quantity imported.

Only two days later, another letter was sent to the SIC, this time from MME. Although not as big as CEM, it was nevertheless an important player in the industry. The letter itself has the same purpose; however, the tone is far less threatening. Mr. Heinze Sierra, the manager, points out the apparent contradiction in policy as the government banned temporary exportation of raw mineral but at the same time allowed tin imports. This was relevant as MME was setting up an electrolytic plan for refining tin and given that regulations forced them to buy local supplies, Mr. Heinze noted that with such cost structure they would never be able to compete against American tin. It followed that the new plant would be a big-time failure if the government kept the market open to imports.

We therefore kindly ask you to take our case into consideration, and if our petition seems as a justified one to you, to ban outright all import permits for tin. Refraining from doing so would mean that granting licenses to all firms would be a better option than producing it domestically."¹⁸

The annex also argues that it has been customary for the government officials to "consult" with the firms in the industry every time there was an application for

¹⁸ 217: Vol., 557., Exp., 14

import licenses before reaching a decision. However, "in the aforementioned cases we've never been notified about the application for such permits."

The answer from the SIC was sent on November the 11th, 1959 (SIC letter classified as 391-III-21076) but did not compromise the government's position. It limited itself to the acknowledgement of MME's position and request. As it will be shown, Mr. Heinze's irritation would only become worse.

The third letter¹⁹ is dated the 27th of April, 1960 and it was sent to the SIC by MME. Attached comes another letter, sent to the official in charge of the committee for iron and steel imports, also in charge of tin imports. In sum, the firm is accusing Mr. Roberto Hernandez (head of committee) of lying; he had paid a visit to the plant in December 1959, by which he attested the existence of large stocks of unsold tin. The government official committed himself to ban henceforth all tin imports so as to get MME's stocks sold.

"Even though in such occasion Mr. Hernandez could see the unsold stocks and therefore made clear that import licenses for tin will be denied, those imports have continued to get into the country at the expense of our firm. We thus expect this department which is called "industrial protection" to effectively block such imports that, we repeat, are a real threat for the domestic tin industry."²⁰

The letter addressed directly to engineer Hernandez is less polite in its language and clearly reveals –again- the irritation of the firm owner, Carlos Heinze;

"You did tell us (during the visit) that out of any doubt, permits for tin imports would be denied; however, most of those firms (that would be denied the permits) have shown us imports of tin they've recently made, a fact we find utterly surprising given that you by yourself could see the tin stocks we have" (...) "thus we kindly request accurate information about whether or not the government will keep granting such permits"²¹

The next letter -dated the 27th of May- shows also that the tin industry faced a far more complex situation than a mere clash between local production and the

¹⁹ 217: Vol., 554, Exp., 7

²⁰ Ibid.

²¹ Ibid

competing imports. The clash was also about the export permits, as some firms, quoting lack of enough processing capacity, would send the mineral to the US and then would re-import it as cast tin. It was a mere commercial operation that did not require any plant -thus it was profitable enough. So Mr. Heinze was reminding the SIC that his firm agreed to follow government's plans as to expand and improve casting capacity in order to achieve a 99.9 per cent purity (in line with international standards), one of the reasons quoted by other firms not to buy local tin. Now then, MME wanted the government to ban such export permits as to force other firms to process the mineral in the country:

"the improvement of the plant (electrolytic process) has had an extremely high cost relative to the scale of our plant; nevertheless we decided to go ahead in order to align ourselves with the government's goal of industrializing the country as far as possible. "

the firms doing such temporary exporting are not in fact part of the tin industry, they are only trading (...) therefore, the only thing they need is to have enough liquidity, and given that such operations are often backed by financial firms, the business can be carried out despite its profits margins being so low, given that they are spared of labour and machinery expenses (...) therefore, we kindly ask those export permits to be banned."²²

Mr. Heinze's words were far from enough to convince the government. by August the 10th, the SIC sent a document to customs officials authorizing "Metales Potosi" to temporarily export 200 tons of the mineral, for refining in the US and re-importing them into the country. The document quotes the "oficio 309-vi-2642" that had previously banned such movements and cancels the decision (in spite of Mr Heinze's wishes). Moreover, the study made by the Unit of fiscal research argues precisely for supporting such practices. Amongst the reasons exposed, there are two: evidence that processing capacity was still not enough to meet demand of cast tin and, evidence of monopolistic pricing as there were only two plants able of processing. Thus, the study argues that temporary export-import permits should be given until processing capacity matches demand, a goal achievable in a year and a half, and adds that firms involved have agreed on this -with the understanding that exports permits will last until capacity is readily available.

²² Ibid

The document also proves that processing firms were accruing monopolistic rents typical from protectionism:

"From the research done by the fiscal unit, it follows that processing firms currently in the market have been charging excessively high prices: they charge three times as high compared with US processing plants. The excess portion of the price is considered as unjustifiable since by no means it is related to a higher costs structure but rather it is a consequence of the monopoly in which they operate. (...) It is thus predicted that, if we allow such high price in processing affect the price of the tin plate, the domestic price structure would be affected as it an essential input on many consumer goods."²³

The document also has a paragraph on conditionality: it emphasises that export permits are tied up to expanding capacity. If they take more than the agreed time, the Treasury would impose an export tax, in fact eliminating the cost advantage of the scheme: "In case of not complying with such condition, the Ministry of the Treasury will impose the relevant taxes over the quantities of mineral that have been exported under the scheme"²⁴

Interestingly enough, only one firm was granted the permit -Metales Potosi de Pizzuto- which may or may not have been the result of policy; if all firms were given permits, they could simply keep a price-fixing scheme. However, not granting them all could mean an attempt to improve competition (since the firm not being granted would be forced to lower its price)

A letter next September by Estaños Mexicanos shows this: the firm is addressing the SIC to enquire about the delay of the permits: "by enquiring about it we do it only because we know that Metales Potosi was already granted a permit, even though they applied for it after we did. So we expect to be granted the permits as soon as possible, just as we presume the reason it has not been done already is because of mere administrative backlog."²⁵

The missive was followed by another one from MME (Mr. Heinze's firm) which shows the increasing irritation of the owner. He denies not only having signed any

²³ Ibid

²⁴ Ibid

²⁵ 217: Vol., 554., Exp. 7

agreement but even having been informed about the shift towards export-import permits. He complains of never being granted with such permits and tries to blackmail the government by referring to the "commitment" they had towards the firm: they would invest in a new processing plant and the government would ban all temporary export permits. (That is, securing the monopoly rents).

The accusations are rather direct: "It is absurd that now exports are being authorized for being processed in the US (after imports had to be brought in to cope with a shortage) unless it meant to give an advantage to someone who is neither in the mining sector nor in the tin industry"²⁶. The person he is referring to is Mrs. Socorro de Pizzuto, who indeed was granted with the export permit and is mentioned by her name in the document. It is then suspicious enough that two out of three firms did not get the export permits.

However, it is also true that Mr. Heinze implicitly acknowledges that he would do same: "Our indignation comes chiefly from the fact that we ourselves have made countless attempts to get such export permits; however, such efforts have been for the most part unsuccessful."

The letter finishes reminding the SIC not only about the investments already done in the new plant but also the commitment towards the firm:

"Given the aforementioned reasons, and given that the SIC encouraged us to build the new plant, we consider there is a commitment towards our firm, so the government should keep its word: export permits ought to be banned, since there is already local capacity to process the minerals"²⁷

In sum: firms in the tin industry did invest as to expand capacity, but once operating, were expecting the government to secure the entire market for themselves. This was initially the case, but as a consequence the price of tin reached \$3.16 USD per pound (versus \$1.03 USD if imported), a substantial rent accruing to three firms. Given that tin was a key industrial input, a higher cost would push the general price level up. But inflation was too high a political cost for the government (and President Ruiz Cortines is regarded as being legitimately concerned about it) so licensing in this case

²⁶ Ibid

²⁷ Ibid

could actually have been used to limit rent-seeking. Other products with fewer repercussions, however, were less likely to get such attention from the government.

4.2.5-Ancillary Industry

The backward linkages of the automobile and ancillary industry are obviously numerous, and not only in Mexico but all throughout the developing world it became to symbolise the politics of ISI: industrial plants were set up despite the market being too small, creating a chronic problem of over-supply while not delivering as many jobs as it had been originally envisaged. In this context, the Mexican experience was also one of chronic over-capacity, yet it is acknowledged that the degree of substitution was above the Latin American average as the industry as a whole did manage to incorporate technical expertise, which could have been driven to some extent by learning rents.

It also epitomises the "cascade" structure of protection: as Bueno (1970) and others have pointed out, the car industry was one of the most heavily protected as a final product, but faced substantially lower tariffs for components, thus ensuring profitable margins. The cases presented here show a mixed record; above all, what is clear is the discretionary basis on which decisions were taken.

4.2.5.1- Radiator caps

Autolite, firm producing different items for cars, first applied for qualitative protection on April 11th, 1960, specifically by asking the Ministry to create a tariff classification for radiators caps and adding it to the list of licensed items. A first, discarded draft originally argued against granting the protection; although it was badly done, probably by a junior researcher who could not even write properly. However, the final letter also denied protection on the grounds that the firm was the only producer of such item and a dominant market position was not desirable. Interestingly, the firm's application does differ from the "typical" language of the "new industrialists" in the sense that it does not play the "patriotic" card, nor

it “demands” the government to fulfil its duty. It is a rather neat case of the infant industry argument:

“We kindly ask this Secretary to reconsider the decision taken on February 3rd, in the sense of denying tariff and qualitative protection for domestic production of radiator caps. (The prices we are offering are indeed lower than the ones used by this Secretary to estimate potential profitability. In fact, our prices are lower than those of imports. The product’s quality has been widely accepted by Ford, General Motors and Chrysler, after having tested the caps back in the Detroit laboratories.

Protection is needed, in spite of the low prices, because retailers insist on not buying locally; they keep on promoting imports since they are subsidiaries and thus have an incentive to sell the imported product. Being our prices lower, we are not interested on a high tariff but rather on establishing a specific tariff classification as to control its importation directly.

We want to underline the fact that we do not wish to be a ‘protected’ industry’; we understand that relying on such an artificial advantage implies inefficiencies in production and in trade, leaving the industry exposed in the long term, as well as creating a burden to the economy. However, we consider this measure as essential only to introduce this product to the market (that is, a product that as of now is imported); a product that will bring benefits to the consumers given its low price and high quality.²⁸

Prices were indeed lower: sold by bulk to manufacturers (lowest price), it had a price of \$3.50 Mexican pesos apiece; sold as spare part its price was \$15.26 Mexican pesos, whereas imported caps cost \$14.50 and \$24 pesos, respectively. The firm, by itself, could meet total demand, since this figure was around 109,376 pieces a year, while total capacity will reach 225,000 pieces –meaning 40% of spare capacity.

In spite of the lower prices, qualitative control for radiator caps was at denied: “It is not convenient to subject the referred article to import controls due to the fact that this firm is the only producer of all kinds of radiator caps used by the automobile and truck makers.”²⁹

The firm appealed the decision and after six months the decision was reconsidered and finally changed. However, there are no data on prices for caps in the following years, so it is not known whether they raised prices after protection was granted.

²⁸ 217: Vol., 311-1/361.

²⁹ Ibid

4.2.5.2-Claxons (car-horns)

Slightly more technologically advanced, claxons represent another case of import substitution in the ancillary industry. As it was the case for radiator caps and, in fact, most of the components, a firm would simply expand and/or adapt its production lines to diversify, in an attempt to increase sales. In other words, it was not necessarily a demand-driven strategy. The attempt to substitute claxons (for all vehicles, not only the ones produced domestically), better documented, offers an interesting window into this process.

The application for protection was sent around the same time than the one for the radiator caps (the firm is the same) and they make a good case for it by providing enough data:

They invested \$870,000. Mexican pesos in machinery, equipment and tools; they hired an extra 45 workers, and the average import content of inputs was 7%. Installed capacity allowed for an output equivalent to 125,000 units per year, whereas demand peaked at 110,000 units a year.

Prices would be as follows: \$22.10 pesos sold in bulk to manufacturers; as spare part to retailers, \$38.50 pesos and \$81.00 pesos as spare part to the general consumer. In contrast, imported car horns cost \$36.00 per unit, not including transport costs, tariffs and taxes, and sold in bulk. Sold by unit, they reached prices as high as \$450 pesos.

The Ministry of the Economy did not grant nor rejected the application right away; instead, they consulted with the National Chamber of Electrics and Electronics Industry which, in turn, carried out a survey of the market and the incumbent firms. It does provide information of a case representative of the ancillary industry –that is, substitutes for the relatively technologically low-intensive components- where over-production was almost the norm.

The study starts pointing out that, on average, and using a value-added basis, import content of car horns produced in Mexico was equivalent to 79.2% of total cost. That means that the estimate of Autolite is, most likely, wrong: they did not factor for the import content of the locally supplied parts of the claxon.

Furthermore, they suggest a better alignment in tariffs as to get effective protection right: most of the imported inputs were still too expensive because of Customs rights

and tariffs. The report also notes that production had jumped from 334,183 units to 493,674 (from 1958 to 59) which represent a 48% increase –or 69% in terms of value -. By far, the conclusions are the most relevant part of the report³⁰:

“Taking into account the data gathered directly and other information we have at hand, there are some facts that must be highlighted: firstly, manufacturing of speakers and claxons in Mexico has not followed a previously designed plan; the reasons why producers started making them in the first do not reflect the need of the industries involved (both automobile-related and other). Those who started production of these items are firms that after a quick success rushed to over-invest in machinery and equipment, lacking an objective assessment of demand. That is why many of them find themselves forced to halt production for long periods of time, when sales go down or even when they face difficulties importing parts that are already produced in the country. In other cases, they pretend to be always ready to sell and produce, so they stock themselves with both inputs and the final product, with the wish and illusion that better times will come soon. However, this rarely happens as their production is not aligned with the industry’s need, especially those producers of radios and tv’s. Taking these facts into account helps understand why the production of speakers and claxons has the following features:

Manufacturing of spare parts for speakers and claxons is still in its first stage, given that the percentage of imported components is higher than that of domestic ones; this is because a lack of coordination amongst suppliers and industry’s needs. On average, only 20% of components are of domestic origin

Unless the cones and magnets (that are imported) are substituted, it will not be possible to increase the percentage of domestically-generated cost beyond 44%.

The lack of tariff classification for both the cone and the magnet mean an increase in the production cost. If the import tax is omitted from overall cost, this figure would go down by 89%, evidently a significant share.

Speakers and claxons do not have a design that responds to the actual needs

There is no such thing as a quality control; therefore, products are not subject to the test that would allow improving its qualities and reducing production costs. It would also be possible to reduce the total number of different models that are being produced.

No market survey has been done as to determine economies of scales (optimal plant size)

Thereby, this Chamber strongly recommends that producers should definitely consider the advantages of a concentrated production (fewer models). Also, producers must standardize some of the products’ characteristics, especially concerning the metrics. This is relevant since

³⁰ 217: Vol., 517, Exp.1.

some firms use the English metric whereas other use the Decimal system, which gives place to unnecessary confusion. In sum, without delay a full programme has to be designed as to take into account the technical and economical aspect of production. This is elementary if the industry wants to grow and meet its goals.

One month later, the Ministry of the Economy agreed to grant protection, based partly in the huge price difference:

For the aforementioned reasons, we suggest that this firm's request (claxon producer) should be approved; that is, granting protection by including claxons and its parts on the list of imports requiring a licence, and by instructing the Trade Department to process all applications. This will foster the development of the industry.

Also, taking into account that domestic producers are able to manufacture their own components, it is also recommended that this Secretary instructs the Tariff commission to include in the tariff classification 762.02.03 the legend "... including all of its parts and components". This, to avoid that foreign enterprise comes to the country and simply imports such components, at the expense of Mexican producers"³¹

In the last set of documents regarding the ancillary industry, there is documentation about radio-car antennas, which are negligible for the size of the industry. Nonetheless, attached there is a decree sent by the President's Office, whose importance cannot be downplayed. It shows that the President was well aware of the abuses trade policy was subject to; by implication, the SIC is left as responsible for such abuses; that is consistent with the hypothesis that the problem did not lie on economic policies as they were designed but in middle-range officials that could be bribed.

"Decree that instructs the Tariff commission to create a research unit to investigate the outcomes of modifications to the tariff structure and proposes the relevant changes concerning the import and export tax" (President's Office Seal)

Considering that,

- i) Tariff protection granted to different industries has the goal of not only fostering industrialisation but also to augment and improve production by lowering costs. This must be

³¹ Ibid

reflected in lower prices and better quality to consumers, being the benefits (of tariff protection) for the society at large and not only to producers,

- ii) Tariff protection must have a relatively long duration, but it has to be gradually reduced as industries develop; in other words, it has to be used by producers in a timely manner, without sparing any efforts.
- iii) (Considering that) In practice, it has been the case that some firms have used protection only to obtain disproportionate profits at the expense of consumers and against the interests of society at large.
- iv) Protectionist tariff policy must take into account the real production possibilities, demand trends as well as the real outcomes of such protection. It has to be clearly determined whether protection should be kept or be reduced (or stripped) as to allow for a moderate competition from imports that would, in turn, speed the adoption of the latest technical advances, making the products cheaper and of better quality.
- v) And considering government's determination to adopt whatever measures are necessary to lower prices and to avoid unjustified price increases,

I (the President of the Republic) hereby instruct the following:

1.- The Ministry of the Economy along with the Ministry of the Treasury must create and coordinate a research unit entitled to investigate everything related to tariff protection with particular emphasis in those cases representing clearly high protection.

2.- In those cases where it can be proven that tariff protection is being abused so as to benefit only to particular firms (as opposed to society at large) the unit must propose the relevant modifications to trade policies.

3.-The Ministry of the Economy must keep records of price variations of protected items, independently from any measure of internal price controls. It must let the Ministry of the Treasury about firms increasing prices with no real reason to do so.

(Signed by President Adolfo Ruiz Cortines, March the 2nd, 1954)

The proposed research unit was not only ever created, but tariff and qualitative protection would only increase in the years to come. How did the SIC manage to “win” this case against the president is a question that remains open. At any rate, more disaggregated data on prices should be included to have a more complete picture.

4.3-“Rising-Rivals’ Costs” (RRC) Rents

4.3.1 The Soap Industry

Interestingly, the case of soap, detergent and lard shows that not all producers could get competing imports banned completely and just by arguing that these damaged the “nation’s interests” (As it was often the case). The industry’s concerns were relatively familiar to public opinion as the chamber of oil producers displayed an aggressive media campaign. An open letter, published in the Universal newspaper (the most important one) the 10th of August, 1950. In it, the chamber makes clear that imports of lard (as an input for soap) and synthetic cleaners are against not only their interests but of the whole productive chain of seeds, grains and animal farms. In a rather direct way, they demand an “audience with the President to explain why imports (of these items) should be banned”. The letter was commented on the daily news briefing to the President, and it even has hand-writing on it (unintelligible).

At the same time, the Chamber managed to bring in a small group of grain producers that sent another letter to the President, complaining -in a naïve way- that imports lower domestic prices, claiming this with obvious disregard for the potential benefits for consumers. Moreover, the importation of lard and (synthetic) detergents "is damaging for Mexico's peasantry" (*"es desventajosa para el campesinado en Mexico"*). The letter, dated 12th of August, 1950, stated that

“Because of the aforementioned reasons (imports lowering prices) we kindly ask you to boldly intervene in this matter as to prevent Compañía Importadora S.A. and Camara Nacional de Comercio de la Ciudad de Mexico from importing these items from the US, given its pernicious effects upon the economy”³².

It was clearly done in tandem with the Oil & Soap chamber’s efforts: first, the timing -one day after the open letter in Mexico City- and second, the odd claim that importation of synthetic detergents is damaging for "Mexico's peasantry". In other words, it is a clear attempt to bring the “peasants” into the fight. It is just the opposite from the powerful chamber: two poor peasants, Cesareo Jimenez and

³² MAV: Vol., 895, Exp. 441(30)/1602

Magdaleno Cruz, from Comitancillo, Oaxaca -one of the poorest regions in the country. This discourse, presenting the producer as the *raison d'être* of economic policy, permeated very much of the business community in Mexico, and not only those linked to the CANACINTRA.

The President's answer was two-folded: to refuse meeting the chamber's representatives -on grounds of "having all audiences cancelled as the President's devoting his time to the upcoming state-of-the-union address" as it was stated in the response³³.

Furthermore, the Ministry of the economy produced a press release that addressed the issue in a more technical language:

Concerning the varied public statements made in the last few weeks by CNIAGJ members (Chamber of Oil and Soap producers) and other producers and businessmen requesting an absolute prohibition for importing lard and synthetic detergents, the Ministry of the Economy hereby declares that:

As the CNIAGJ's board can attest, the government has been carrying careful studies of both internal and external market conditions for oleaginous seeds and grains, as well as about the needs of producers relying on oils and fats as key inputs. It has also maintained a policy of wide support to agricultural and industrial producers which has been translated into remarkable increases in domestic production, which is also a result of the *positive engagement* of the private sector with such policy.

Given output increases, the Ministry of the economy has established targets for import reductions of animal fats. Imports of beef lard have been banned and thus suspended completely, whereas importation of pork lard has been not only gradually reduced but kept under the exclusive right of CEIMSA (state-owned company). This in order to regulate the price and to avoid *unfavourable competition* from foreign products that would harm producers of these items.

The ministry of the economy has confidence that it will be possible, without damaging consumers, to ban in the near future imports altogether, given the low prices and improving quality of domestic production. For the *definite triumph of Mexican producers' interests*, the government will implement a set of measures that will only have, as boundaries, the satisfaction of the consumers at large. (...)

Regarding the importation of synthetic detergents for household consumption, the Ministry decided to regulate it through the licensing system, as to avoid excess imports that could

³³ Telegram number 21058, 11th of August, 1950. Sent to Camara Nacional de la Industria de Aceites, Grasas y jabones. MAV, Vol. 895, Exp. 441/ 1602

seriously damage the soap industry. However, an absolute ban of these items as requested by the Chamber of Oil and Soap industries was not implemented, considering that consumers' interests are superior (to those of the producers)³⁴

The letter was published just a few days after the Chamber's first move, and not only in the *Universal* (the paper with the highest readership) but in all major newspapers. It was obviously intended to convince the public opinion that economic policy measures were taken according to technical criteria while at the same time insisting it would not damage industries or producers, as the chamber was claiming. Two elements of the letter's wording are worth emphasising: First, it is clear that the government does not want to compromise its position to either group; rather, it starts acknowledging the private sector as a partner (the "positive engagement") and tries to convince the reader that it is possible to accommodate everyone's interest, that such clashes are not zero-sum games (minimizing the obvious fact that producers' interests are precisely at the expense of consumers). Second, the wording also reflects very accurately the narrative of ISI in Mexico: to start with, there is "unfavourable" competition; it is referred to in negative terms. So the less competition, the better, is the bottom line. Consequently, imports are always a sign of weakness -attuned with *Cepalismo*, quite obviously- The "*definite triumph*" implies not only a race but cutting imports as the main goal. That is why what the government offers in the letter as the ultimate concession is the "absolute ban" of American lard and detergent. As a narrative for coping with particular demands it was perfectly suitable. However, internal documents prove the reality was otherwise.

It has been shown that beef lard was already banned -the SIC publicly declared so in the letter transcribed, and the measure was indeed officialised by being printed on the *DOF* the 14th of July, 1950. Interestingly, in the Presidential archives there is also a special import permit³⁵ that proves the government was, in fact, lying. First of all, beef lard was banned from being imported, and second, the state agency (CIMSA) was the only one authorised to trade any kind of lard and oil for the soap industry.

³⁴ MAV: Vol., 895, Exp., 441.

³⁵ MAV: Vol., 895, Exp., 441(30)

The permit quotes the tariff classification -1-23-39- (beef lard) is addressed to General Escobar and entitles “Comercial Inter-Americana, S.A.,” (a private firm) to import 5,000 tons through any custom in the following 180 days. It includes an explanation:

Mexico does not produce enough quantity of beef lard as to meet national demand (...) the quantity imported will be distributed across the country so as to not affect other similar products (...) Moreover, with the Korean War and the possibility of an international conflict, prices of all oils and fats are increasing fast so it would be convenient to buy as soon as possible. *Of course, this permit and the acquisition of lard will be treated with absolute discretion and in a sensible way as to not disturb the market. (in Spanish: Desde luego el manejo de este permiso y la disposicion del sebo se hara con toda prudencia y en forma reservada para no alborotar el mercado)*

There is an import committee for oils and fats formed by officials of the Ministry of Agriculture and representatives of the industry. Applications for import permits for these items are seldom given: the committee instructs the Ministry of the economy that such requests must be turn down. Therefore, this permit for 5,000 tons we are interested in must be processed OVER AND ABOVE THE OILS AND FATS COMMITTEE (capital letters in the original) ³⁶

Clear enough, this is a straightforward case of successful rent-seeking. The words in italics and in capitals show that the grantee was very aware of the sensitive nature of the benefit given to him. “*to not disturb the market*” means not only preventing it from actually working properly -allowing the price to fall- but also means that disclosing the information would actually prove the government lied to the public in the letter.

The importer, with the permit, would gain from the fact that lard was in short supply -as a key input for the soap industry- *and* from the fact that restrictions to importing it had already increase its price. In that sense, the importer will benefit from the situation by which local producers of lard were already accruing rents. Therefore, the rents will come from either selling at the same price -or just marginally lower- or even at a higher price if the importer is able to hoard the lard long enough (betting that war would increase prices even more). In any case, the excess portion of the

³⁶ Ibid

selling price would come not only from the fact that there is a captive market but also because even at the same selling price, the domestic producer faces higher costs.

Theoretically, this equals to the "Rising-Rivals'-costs" model of rents; the firm "Comercial Inter-Americana, S.A.," was competing with other local suppliers on selling lard and oil to the soap industry. Previously, Comercial Interamericana was buying lard locally. By getting the permit, it automatically cut costs and therefore widened profits, even if prices remain the same. Even if this firm was in reality part of the soap industry -that was oligopolistic all throughout the twentieth century- the same model explains the logic: by being the only one with import permit, the competitors are forced to buy the more expensive local inputs.

4.3.2 The Export Sector (trailers, tractors, wrapping materials)

These two cases show very clearly the extent of cronyism within the SIC, as well as the ever-growing importance of imports. In both cases, it is about exporters trying to get a permit for temporary importation of transport vehicles. This was a common request as many small firms would need to move their produce once or twice a year but could not afford to own their own vehicles. There were a few firms offering the service but that was not cheap, either. So the most cost-effective measure for those firms would be renting vehicles on the other side of the border, load their product and then return the vehicles once it had been delivered. However, the government's goal of having a domestic car industry and the policy of banning an item the moment it was produced in the country meant that less and less temporary importation permits were granted. Of course, both the car-makers and the transport firms had a strong interest in keeping a captive market.

Interestingly, the exporter without political connections -Cayetano Mascaregnas- is forced to buy the domestic vehicles or else, whereas the politically connected gets the permit.

The letter³⁷ by Cayetano Mascaregnas was sent on September 19th, 1958 and explains why he needs to temporary import 10 vehicles:

I, Cayetano Mascaregnas, as representative of the local meat producers, kindly request this Ministry a permit to import 10 vehicles for livestock transportation (exports). This kind of vehicle has one wagon attached to the cabin and a second wagon.

This particular kind of vehicle is neither available in the region nor produced in the country. Even if they were produced in Mexico it wouldn't be affordable as they are used less than 6 months a year. All these vehicles are easily identified as they have plates on both wagons.

Thereby I am applying for a 6 months permit only. Livestock amounts up to 6,500 heads, weighing on average 300 kilos. Each vehicle can transport up to 60 cows, and it takes between 13 and 16 days for the round trip, including the three days it takes to go through the legal requirements of registering and clearing exports.

In addition, the Ministry of the Treasury has already given its approval; therefore, the Ministry of the economy is the last Ministry we need approval from.

The "oficio" 391-VII, dated the 9th of January, 1959 (four months after the request was made) shows that the Ministry didn't approve Cayetano's petition -again, producers interests were given priority even over exporters, which is striking enough given the country's chronic deficit. The document lacks details and accuracy, what makes the decision all the more suspicious. In a rather short paragraph it says: "Information was obtained from 'El Aguila' in the sense that they are able to produce the full trailers in 25 days from now" These two lines were enough as to deny the permits: "given the results of the study (!), this department recommends the permits to be denied on the basis that there is domestic production of the vehicles in question".

What is striking -and this was found in other similar rejections- is that the Ministry only enquired with producers, but did not actually corroborate the information. So it was very easy for domestic producers to force buyers to acquire close substitutes, or to charge higher prices. Whether it was a matter of the ministry lacking enough resources as to be able to check every single claim or it was simply because they would always support domestic producers anyway is not clear.

³⁷ 217: Vol., 554.20/511.01/727 Exp. 8

The second document proves the Ministry's arbitrariness. It is a letter dated the 10th of February, 1958, also addressed to the Director of "Industries" within the SIC. The sender is requesting permission for importing temporarily twelve refrigerated trailers:

"As to mobilize to the United States the important harvest of tomatoes from the state of Sinaloa, your authorization is urgently needed to import on a temporary basis 12 refrigerated trailers. We own the motorized vehicles (needed to use these trailers) which are properly registered before the Transit Department. (...) having confidence on your kind attention and extremely valuable help, I reiterate my highest esteem and respect for you."³⁸

On the next day, an internal document³⁹ shows that the petition was approved: "The Department of Commerce has made it clear it has no inconveniences by granting the requested permit (therefore) this Secretary thinks that the petition must go forward".

It is worth noting that it took those 4 months for processing Cayetano's request, whereas Mr. Gonzalez Alvarez's application was speedily process in one day only. Moreover, the pre-requisite of making sure that there was no domestic production was ignored at large. So the Senator's business card speaks for itself.

Three other cases only reinforce this point. Another exporter, Mr. Heliodoro Ramirez, complained to the Ministry, a year after Cayetano's request, about the lack of enough supply of transport for exports. He refers to two other firms, one in Santa Clara (state of Mexico) and another one in Irapuato (state of Guanajuato) both in need of refrigerated transportation for fruit (these locations are more than 700 km away from the border). The sender remarks that such firms are forced to delay their shipments on a frequent basis precisely because of inadequate supply of this sort of transport.

Another file⁴⁰ contains the transcription of a telegram from an angry meet exporter plus the following responses. The telegram was first sent the 29th of July, 1959,

³⁸ 217: Vol.,554, Exp. 20/511.01/727.

³⁹ 217: Vol.,554, Exp. 20/511.01/727 letter from Direccion General de Industrias.

⁴⁰ 217:554,20/511.01/727

whereas its response was signed on October the 4th. on it, the owner of a meet firm ("Compagnia Refrigeradora Lagunera de Productos Alimenticios, S.A.) states that:

"Given the scarcity of refrigerated trailers and deficiencies in transport services we are forced to suspend the exportation of the meet we produce, with dire consequences for the local livestock and meat industry. We therefore ask for your intervention so the Ministry can approve the importation of two refrigerated trailers that would be pulled by Mexican vehicles. We are grateful for your help on this matter"

More than two months later the application was formally accepted, which means there was increased awareness on the Ministry about the exporters' problem. However, the application had a not so minor condition: the firm had to pay to the Treasury a deposit worth 100% the value of the trailers, a requisite never asked to Mr. Gonzalez. The measure would in fact double the cost of transport, thus deepening the anti-export bias of the exchange-rate policy. It could have been the case that this was a polite way of denying the imports, since only bigger firms would have enough liquidity as to pay up-front the deposit plus the actual cost of the trailers.

The last case of this type is a list of 59 individuals requesting permits for importing second-hand tractors. It lists the name of the person, type of tractor and value in current pesos. All the applicants were peasants working in the cotton fields. Being cotton the core agricultural export, it would be expected that it would be given priority. Strikingly, that was not the case. The internal document⁴¹ discussing the case plainly says that

"This department would like to let the Ministry know that it is not convenient granting such permits given that such measure would affect domestic transport industry's interest (...) it can generate protests from this sector"

Whereas the answer to the applicants limits itself to state that "the reason being, similar tractors are being produced in the country"

⁴¹ 217:391-III-511.01/727

Transportation was evidently critical to exporters, but their problems didn't stop there. As it is shown in telegrams and documents sent by the *Confederación de asociaciones agrícolas de Sinaloa*, wrapping and packaging material was also subject to tensions between exporters and the Ministry, as those materials had started to be produced in the country, but not at enough quantities as to satisfy exporters' needs. As the telegram 33979 received on Oct., 11th, 1958, shows, a delivery of oranges had to be cancelled because of lack of wrapping paper, which caused a heated letter to the Ministry. The subsequent efforts to substitute both wrapping paper and wooden boxes show that even for technologically low-intensive products there were difficulties to match US prices by mere differences in scale economies. This was a real problem and it has been emphasized as one of the core structural barriers to a successful substitution.

In any case, these two cases show the effort put on setting up local producers. Perhaps because of its low technical requirements, wrapping paper was successfully substituted. The documents, (217:556, exp1) full of technical details, include an independent report done by the Mexican Institute of Technological Research that certifies that wrapping paper produced by the firm La Aurora complies with the US standards (this is relevant as wrapping paper has chemicals to protect the fruit).

Also, the firm provides data to justify a 12% on average higher price than the American imports: the core input, cellulose, was at least 30% more expensive in Mexico than in the US, plus all the tariffs on machinery and spare parts that were needed to operate the plant.

Still, the Chamber of Paper producers was blocking any imports, as stated in the letter⁴² sent on Oct 10th by which they argue that La Aurora -the firm certified by the Institute of Research- is ready to produce exactly the same paper. The exporter firm -*Empacadora de Naranjas Mexico*- was willing to buy supplies from the local producers, but again worries about prices were high:

"We are willing to give preferential treatment to your product (over the American import) as long as you can guarantee the quality so dyfenyle will preserve the fruit (this had already been

⁴² 217:511.04/737.

done). And, moreover, as long as you offer a better price, given that the first offer was too high for such product"

Two months later, while still waiting for an answer, the agribusiness association sent another letter showing more commitment but at the same time making it clear that local suppliers were far from reliable:

We emphasise the fact that it is not only our policy but that we will make all efforts as to acquire wrapping materials made in the country, given their lower prices. However, it has to be said that last years' experience of significant delays (on the delivery of wrapping materials) was outright disastrous for our export industry. That is why we are now asking permission to import, as an emergency measure, such materials:

- i) For the "Agricola de Mayo" Association: 1,500,000 tomatoes boxes plus 300,000 boxes for fruit
- ii) For "Valle de Guaymas" association, 450,000 plus 230,000"⁴³

The suppliers' record was not enough to persuade the Ministry of the need for more imports; instead, they pressed ahead with the substitution of such materials, first by sending an inspector to assess whether domestic firms could in fact meet demand and secondly to commit those firms to a production plan. That, at least, was stated in the internal document num. 20 (217: Vol., 556, Exp.1)

As per the verbal instructions I was given, concerning information on the production of wooden boxes and cases suitable for vegetables, I visited the following firms: i) "La Estrella", ii) Rodolfo Sanchez Cia. And iii) Reguerin y Martinez. The managers of the three firms did confirm they can produce up to 150,000 boxes (all together) per week.

(Therefore)

"Considering that there are firms in the country capable of supplying such materials, it is considered to be right not to grant import licenses in this case."

"Based on the quoted study, it is not convenient to authorize such temporary imports"

So that is why the second offer emphasises that prices are only 12 on average higher than those of American imports. The SIC decided it was worth the substitution and

⁴³ Letter dated Nov, 1958. ConFederación de asociaciones agricolas de Sinaloa: Fondo 217: Vol. 556, Exp.1

thus cancelled, from then onwards, permits for such wrappings. However, without data on the profit margins of the orange exporter, it is difficult to assess whether the increment had a significant impact upon the business competitiveness. At any rate, it is clear that local producers, again in this case, had the upper hand over exporters.

4.3.3- Submersible pumps

This case is of interest because it epitomizes the transition from an easy ISI phase to the second stage; it shows the difficulties posed by technologically more demanding import substitution as well as the tensions with local producers (of more complex products) who had little patience for the learning process.

The four documents available are letter sent by KSB Mexicana -producer of submersible water pumps- to the Ministry of the Economy and the subsequent replies from both the Ministry and the local producer who offered a substitute for a crucial input, namely, the water-proof motor. Needless to say, submersible water pumps were increasingly important given the rapid expansion of the irrigated areas; by then -1959- the agricultural frontier had not been reached, and irrigation works were of priority for the government. This was especially true in the mechanized north, producing most of agricultural exports.

The document⁴⁴ written by Mr. Notholt, KSB's manager is an extremely detailed account of the technicalities involved in the case -or, in other words, of the shortcomings of the newly produced substitute. On it, the firm complains not only about the local producer but about the Ministry as well, given its position of not granting import permits for any kind of motors. (It has to be noted that motors had its own imports committee, with representatives of local industries)

“On May 6th we sent a letter to Fundidora Irapuato, by which we asked for a proposal concerning the motors we need to produce the submersible pumps. With a delay of more than 5 months, we finally got a reply, but only after asking for help in the Ministry of the Economy. In the meanwhile, we have been unable to import those motors and thus we have almost

⁴⁴ 217:555, exp9. 22nd Oct., 1959.

halted production. It is completely unacceptable that an industry has to rely on a single supplier who, on top of everything, needs more than 5 months to prepare a proposal”

The letter goes on reporting, in great detail, six points that ought to be addressed; the first 4 are quite technical and clearly shows that the local firm lacks the expertise to meet German standards. The last two points are related to prices and business practices:

“Prices quoted are on average 60% higher than the imported motors, even taking into account the tariff 730.02.09 on general importation. Being Fundidora Irapuato not only motor producer but also submersible pumps producer as well, we wouldn’t be able to compete with them if we are forced to buy their motors, whose prices, we think, were set too high as to protect their submersible pumps. Not to mention the fact that any industrial product must have a warranty, and if we don’t get one for our supplies we cannot offer one to our own clients”

The document ends with a substantive claim; namely, that Fundidora cannot pretend to be competitive in the whole range of products of the motors and pump industry. It notes that submersible motors are complex devices that call for a sustained R&D effort. Given that Fundidora produces 37 different motors, with a capacity of 300 units per year, the letter notes that experience will be limited to 8 units per year, barely enough as to reach high quality standards. Following this comparative advantage logic, Mr. Nohlohlit insists that the German plant, producing thousands of motors a year and with a proper R&D department, is far better suited for the production of this motors than the Mexican counterpart; moreover, allowing its importation would ensure that the latest developments in the field would be available to the Mexican consumers. It ends with the hope that the Ministry of the Economy would follow technical criterion to settle the matter:

“So we kindly ask this Secretary to seriously consider our request as to give us support (the reasons explained in our letter on the 22nd of July) even though such request is not convenient to Fundidora Irapuato, which by the way produces submersible pumps in a rather improvised fashion. We will be happy to back with hard evidence all of our claims; thus, we would be grateful if you can appoint a technician for that purpose”

In spite of the impeccable logic of the Germans, the government did not agree and forced them to buy the domestically produced motors by both including those motors in the licensing list and then refusing giving permits, as stated in the letter (391-III-20814) of the 7th of November. The SIC managed to get Fundidora to offer the guarantees asked by KSB, but it is unlikely that all technical requirements would be met by decree only, as it was so often in the ministry of the economy. It is also telling that this letter was copied to the imports committee on motors, which strongly suggests they were instrumental in blocking KSB petition.

4.4-Rent-Extraction

4.4.1-Acapulco Customs

Since the implementation of high tariffs and qualitative controls, the issues of smuggling, corruption and extraction of rents from custom officials was suspected at least if not clearly known by the government, especially by the Ministry of the Treasury that had an interest in revenue maximization.

An example of this is the letter⁴⁵ sent by the representatives of the Transport Chamber for the route Acapulco-Mexico City. It is dated October the 1st, 1956, addressed to President Adolfo Ruiz Cortines and was stamped as received -and as confidential- by the President's Office. It gives an account of the *exactions* asked for in addition to the legal levies by a wide range of custom officials: from the warehouse keeper to the official in charge of approving the legal documentation – the "*agente aduanal*".

We expose to you the exactions truckers are subject to from Custom officials at the Acapulco Port, who, in addition to the levy they are entitled to charge, they charge drivers with the following payments to deliver the load to the highest bidder, a practice we consider unlawful. Such charges are as follows:

- i) Custom agents sell the load that arrives to the Port to the established (transport) lines at a rate of \$20.00 pesos per tonne (sometimes up to \$50) quantity that the driver has to pay from his money

⁴⁵ ARC: Vol., 464.564.2/597

ii) In addition to this exaction, they send an employee to the gate, to whom drivers have to pay \$5.00 pesos per trailer (even though the official quota was already paid)

iii) Another charge is exacted by the federal employee attached to the Ministry of the Treasury who acts as Head of Warehouses. He has to be given \$10 pesos to issue the permit for loading in the Customs area.

As if these charges were not enough, the gate keeper asks \$5 pesos to let drivers in.

All these exactions are imposed upon the finances of drivers, since custom officials charge the merchants separately for custom services and surcharges.

Moreover, even the workers loading the merchandise demand a payment for their work, even though this was already charged to the merchant in the "expenses bill". That is to say, these people charge twice for the same job"

The business is quite attractive to all of them, since on average the custom receives five thousand tonnes of merchandise every month, so at the minimum rate of \$20 pesos per tonne, it means a profit of \$100,000 pesos a month to the custom official only. If we take into account that such quantity takes at least 700 trips to be moved, it means a profit of \$3,500 pesos to the customs employee and the same quantity to the gate keeper, whereas the Head of the Warehouse pockets \$7,000 pesos a month.

We send this complaint on a confidentiality basis as to avoid retaliation and perjuries to our interests. We also do it in behalf of "Lineas Unidas del Sur", Transportes Independencia", "Transportes Figueroa" and "Central de Lineas" as the owners are afraid of speaking out because of the likely retaliation measures that would follow from the custom people, including the merchandise being seized altogether. That is why they are subject to this extortion ("exploitation" in the original) and it is, quite often, the firms' agents who personally deliver these payments to the custom officials.

Custom officials also sell (illegally) merchandise to the firm "la casa de Oviedo" located in Acapulco. This is against the Federal Law of Transport and Communications: transport of goods in bulk has to be done by authorized vehicles. However, the owner of this firm, who happens to be Spanish, simply pays a higher premium for the custom's people co-operation.

Given all the aforementioned reasons we therefore urge to take the necessary steps to bring these people to court. We, other businessmen and the drivers are willing to provide evidence as to terminate this extortion." (This was signed by ten people: Serafin Ojeda, Ramon Laguna, Jose Romero, Jorge Rojas, Salvador Rizo, Raul Figueroa, Jose Garcia Cardenas, Hector Camargo, Juan Garcia and Arnulfo Rizo)

Earlier reports⁴⁶ had given account of this; the Ministry of the Treasury had been dealing with corrupt officials all throughout its existence, but it was clear that

⁴⁶ Fondo de Hacienda, 1953, Vol., III, Exp., 12

extortion was becoming widespread at customs as protective measures were on the rise. Not only the volume of trade had increased substantially but also there were far many more regulations to follow -such as the Rule XVI that requires de identification of the product- that would mean more opportunities for rent-seeking.

The President's correspondence of Adolfo Lopez Mateos contains an even more serious case of well documented rent-extraction and smuggling. The file 564.2/608, number 29514, dated 7th of December 1960, addressed to Sr. Leon Garcia (complaints and suggestions Unit) acknowledges the letter sent by an administrative employee -Manuel Fernandez- at the Tamaulipas-Laredo Custom: "(He) denounces a number of staff and custom officials that allow smuggling at large scale, including luxury and sports cars. Specifies details of such activities, and says will keep reporting".

The 23rd of October, while being on duty in the Old Bridge, gate number 1, in the shift from 22 pm to 06 am (next day) the following personnel: private Rodriguez, three gate keepers and Official Vega, (I witnessed that) around 22:10 pm, right after the shift had started, there was a phone call from the sergeant instructing private Rodriguez to reinforce surveillance of the central office. He did so because he would interfere with Official Vega's intention of letting in a trailer with brand-new refrigerators.

This operation had been planned and agreed in advance, given that they were able to present the "shipper export (certificate)". Don't you think his betraying the confidence you have on him, Mr. President?

Furthermore, on Nov. 4th, private Matamoros and three other gate keepers, while being in a station near La Joya, 135 Km. from the border, caught two cars driving south; a Chevrolet 1954 first, that was asked to show the relevant documentation. The driver showed a permit from March 1954, issued in Torreon. However, it is known that permits granted in such years match cars whose gauge is in kilometres, not in miles as it was the case. I saw that while the private wrote the report to be sent to the station, the driver told private Matamoros to accept \$200 USD: he was not even the owner and was only delivering it (the private refused to take the money). Then the second car approached. It was a Lincoln, model 1955 or 1956, with American plates but nothing more; the driver did not have any documentation to show. A report was also issued and sent to the station, and I wonder where those reports could be, as the cars were let free by the Officer in charge. If this information is corroborated I personally will identify the drivers if required to do so.

A third incident took place on the 24th of November; this time, Commander Cesar Munoz caught Capt. Macias on the spot: he let a cargo full of smuggled items in. Fortunately, the commander apprehended him and took him to the Central Office. Therefore, I will keep informing about such incidents.

Not surprisingly, cars -and especially the compact and luxurious ones- were amongst the items with a higher participation in the chronic deficit. Not only that, but also it proves extremely difficult in practice to control its importation -as the two last cases show. Despite all the controls, a growing high-middle class and the local elites in the urban centres were demanding cars more and more. There was clearly a market for luxurious cars, as the following letter shows.

This is a case of the blatantly discretionary basis on which licenses for small cars were given. They were part of the first group of imports first subject to licensing back in 1947 [the final decree was published in 1950]. The letter⁴⁷ was produced by the Mexican branch of General Motors -that had established since 1940- as a complaint about unfavourable decisions regarding import licenses for small cars. It is addressed to the Ministry of the Economy and it uses a somewhat rude language: it lacks the politeness usual in those letters and presents the government as a liar -without using that word, but close enough.

With due respect, we would like to raise the following points:

- i) First of all, domestic market is not saturated; it can't possibly be saturated since the Ministry of the Economy has clearly indicated to us that not a single import license has been granted.
- ii) Second, as a matter of fact, different retailers across the city -who are not authorized sellers, by the way- have kept importing precisely the same kind of vehicle we are asking permission for.

As concrete evidence, though not pretending denouncing anyone, we provide you a list of 7 people that, after being unable to buy the vehicles from us, bought them from those unauthorized retailers" (it lists three Cadillac convertible, two Coup the Ville and two El Dorado, along with the names and addresses of the owners.

Most of them have already registered their cars in the Transit department, while the rest is still driving them with American plates. Moreover, there is one particular retailer located in Av.

⁴⁷ ARC: 464.564.2/511

Chapultepec 446 that even offers different brands (also subject to licensing) and have them on display.

For these reasons, we kindly ask you to reconsider the decision quoted in the previous letter and thus the permits can be granted to us. By insisting in getting the licenses, we do it because of the simple reason that we believe we are more entitled to it than the unauthorized retailers that do not face the same costs as we do and, moreover, because we are in this business since 1940.

Looking forward to a favourable resolution, we kindly appreciate your consideration.

This letter had not been the first one: the firm had already complained that the Ministry would deny authorization quoting that “given the fact that demand for this item in the domestic market is being met satisfactorily”.

Clearly, the Ministry was granting permits to import such cars (besides the smuggling that is) but subsidiaries of American firms were not the lucky ones. This is a classic case of rents accrued by retailers, as modelled in Krueger (1974): it is about a final product whose importation requires a very scarce licence. As such, the probability of getting it is low, but once a retailer gets it, profit margins are wide since there are no production costs. As statistics show, even though imports of small cars were kept relatively low, it was never completely stopped –in fact; it rose in both absolute and relative terms.

4.5 – Conclusions

Although it is difficult to quantify the size of rents with the data provided by these documents, they clearly show that trade policy during the fifties was more determined by the need to reconcile opposing interests than to reduce the deficit. Moreover, in most cases –such as the exporters, the soap industry, submersible pumps– clearly show the arbitrariness with which trade policy was conducted –or, in other words, the extent of cronyism. Perhaps the most blatant example of this is the letter with the senator’s business card attached: it took the Ministry one day only to process the application and grant an import permit, while in “normal” cases it would

take months only to send the first reply. Not to mention the telling fact of by-passing the requirement of proving that such items (in that case, refrigerated trailers) were not being produced in the country.

The submersible pumps case shows one of the limits of the ISI strategy in Mexico: that of technology. It is clear that Mr. Notholt was right: a recently created firm producing dozens of different models and under-investing in R&D would never be able to compete with German expertise. In that sense, it shows the mistakes concerning technology transfer: instead of going through the technological ladder one step at the time, more often than not the Ministry would pretend (or being convinced) that firms were capable of substituting the *entire* product since the beginning. As the detailed accounts of Mr. Notholt show, this was simply not possible.

The ancillary industry cases are clear examples of one of the worst outcomes of qualitative protection: by closing the domestic market entirely, firms would more often than not end with chronic over-capacity problems.

In all, these are neat examples of one of the major “sins” of ISI in Mexico: the priority given to the domestic producer not only at the expense of consumers, but at the expense of a better technology-transfer path and productivity gains. Moreover, as the decree by Ruiz Cortines show, top officials knew about these limitations, and at least in his case there was the willingness to correct the abuses. Sadly, time showed that rent-seekers were far more successful than economic planners.

CHAPTER FOUR

QUANTITATIVE APPROACHES TO RENTS FROM TRADE RESTRICTIONS

ABSTRACT: the aim of this chapter is to present three quantitative tests that provide further evidence for rent-seeking through trade controls. Although these tests are somewhat conceptually different between them (they include legal and illegal rents), they are presented together since they imply an aggregated perspective. The first one is an analysis of the nature and timing of decrees declaring specific items as “banned” (i.e. its importation could only take place through a license). The core aim is to show whether there the licensing system was internally consistent and whether redundant protection was being granted. The second test provides a rough estimate of overall smuggling by comparing the data on American exports to Mexico with the data on American imports to Mexico – the latter are consistently higher in value than the former. The third test is an overall analysis of the importation to Free Perimeters (FP); descriptive statistics of their growth and magnitude, as well as comparisons vis-à-vis general importation using per-capita standardizations show that such special areas were used as a source of cheap imports that would be smuggled into the rest of the country – effectively generating rents. All three tests point toward the ultimate unsustainability of the non-tariff trade controls.

5.1.- INTRODUCTION

As this research project was originally conceived, one of the core empirical tests was meant to be the analysis of individual import licenses granted over time: by year, type of good, value and volume of imports. Moreover, the ratio of licenses granted over rejected ones, as well as and the name of the firm (the nature of the business, at least). This would have allowed for a correlation exercise with the overall trade deficit in general and with the contribution to it by specific goods, in particular. Furthermore, it would have allowed for an analysis of the correlation of license-granting with price movements and profitability of particular industries, the latter being a crude proxy of rent-seeking. These last two tests are particularly relevant from a theoretical standpoint: it is reasonable to expect a *direct* correlation between licenses (for imports) rejected and price increases, at least in the import-competing categories of goods and those being inputs for production. In other words, it is reasonable to expect that the domestic producer will try to block imports as much as possible and reap the benefits of artificially high prices –and this, despite official price caps and controls.

Chapter Three already showed this was a constant worry within the government – whereas the private sector would constantly reject the accusation.

However, for intermediate and raw materials the expected relationship would be an inverse one: assuming that a previously imported input was banned (thus rising costs for all firms using it) those firms with a license to regain access to it would improve their margins. The case studies show how important was access to cheap inputs: considerable lobbying took place to get access to such licences.

By extension, the dynamics of license-granting would heavily impact profitability; as it has been explained, the expected relationship between profitability and licenses granted would be *negative*: the fewer licenses are granted, the less competition for domestic products, boosting profitability.

With the relevant data on licenses, price sub-indices and profits it could be possible to measure the “sensitivity” of the factor by which an added license would impact prices. However, three fieldwork trips to the National Archives failed to produce this data (See Introduction); most likely it was lost or even destroyed, since the government would not have wanted the business community to know exactly who was getting exactly what license. Besides speculation, the reality is that only data for a single year was year was found. Not to mention that prices are the “official” ones: the ones actually *paid for* are not to be found in government publications, and private officials themselves reckoned that price caps and control were difficult to enforce. This is, of course, very unfortunate, since comparing changes in licence-granting with changes in prices would have provided a very reliable and solid test from the rent-seeking perspective.

Fortunately, it is still possible to somehow quantify the license-granting; though cruder and imperfect, an alternative approach is to focus on the *categories* and *particular items* being banned from importation: how the list of “banned” items (i.e., requiring a license) grew over time. It is not as accurate as the data on permits granted/denied –that is, actual importation- but it nonetheless provides valuable information. Such compilation, however crude, has never been done; only the percentages of licenced items over total importation for some years have been published, as already noted.

What should be stressed is that even lacking micro data on license-granting, a descriptive-statistical analysis of the specific items (or categories) and their *timing* is worth pursuing since it has never been done before. By carrying such disaggregation

exercise, it will be possible to have a better understanding of the timing of the implementation of quantitative controls; moreover, it will be possible to confirm whether it was “very rare” for a product to be taken out of the list once it was included, as the literature has pointed out (Izquierdo, 1970; King, 1976; Balassa, 1976). In that sense, the first section of this chapter will provide *indirect* evidence for rent-seeking: not only finding economically-odd products whose exclusion makes little or no sense at all but, moreover, the *extension* of protection beyond the boundaries *set by the government itself*. Every extension of permits would mean, by implication, successful rent-seeking: why would otherwise the government systematically deviate from its own-set goals?

Interestingly, on the larger picture there is strong evidence that support this: the first attempts by the government (specifically, by a fraction of reform-minded government officials) to adhere to the GATT were effectively blocked by the lobbying of the manufacturing sector; the industrialists knew there would be big losses had a programme of trade liberalisation taken place. This happened in spite of intense pressure from the IMF, which had already negotiated a time-table for liberalisation in exchange of the financial help the country received after the 1976. Along with intense pressure from the private sector, came the discovery of huge oil reserves – thus a suddenly stronger economic position- meant the abandonment of such plans. In any case, what matters here is that liberalisation was effectively postponed because the private sector managed to impose its view on the subject, thus protecting their interests –see, for instance, Greene (1994).

As explained in the introduction, even though the licensing as trade policy was not substantially reformed until 1985, the period of interest ends in 1976, with the first serious crisis of the ISI model in Mexico; a balance-of-payments crisis forced the government to devalue the peso for the first time since 1954. As a consequence, the licensing system was diverted toward short-term goals –namely, deficit reduction. Thereafter, in 1978, the discovery of oil completely altered both the immediate economic outlook as well as the development model: the years 1976/78 mark the shift from ISI “proper” to the “one-sector” model where oil would obviously be the driving factor (De Mateo, 1988; Levy, 1988). It is clear, then, that after such transition the licensing system can no longer be judged in the same terms as during

the 1947-1976 –roughly the “stabilizing development” period. The conditions changed so much that by the 12th of December, 1980, a decree was published in the DOF establishing that the imports included in the tariff classification from code 01.01-A.001 to 98.03.B.999 were under licensing control. That amounts to practically 99 per cent of all imports. As the balance-of-payments worsened, the 17th of February, 1982, the government declared all imports, with no exceptions, under control –and even then, the measure was not enough to avert the forthcoming crisis. Whereas the analysis of items protected by the licensing-system could be seen as the analysis of “legal” rents, section two and three deal with a conceptually different source of rents –namely, smuggling- that falls into the category of “illegal” rents (see: Krueger, 1974).

Albeit a different category from rents accrued from quantitative controls, smuggling should be considered first and foremost as a direct outcome of the licensing system (i.e., the natural consequence of excess protection): by excluding some imports altogether, the incentive to bring them illegally into the country is simply too high to be ignored. Adding to wide price differentials, there is the question of low salaries for bureaucrats in general and custom officials in particular (as shown in Chapter three) which only makes a self-sustained bribery system more likely to entrench itself into the border economy. In that sense, smuggling can be seen as evidence that the licensing-system was bound to fail in a country that happened to share a border with the biggest market in the world.

Thus, section two is an attempt to get a snapshot of smuggling. Partly inspired by the letter described in Chapter three, in which an American fruit exporter complained to the Mexican government, as early as 1948, about the unreported American produce being sold in Mexico. Essentially, section two compares the data for American exports to Mexico as reported by the US government with the data for American imports as reported by the Mexican government. There is, indeed, a continuous gap of missing value, which amounts for merchandise illegally introduced into the country.

Finally, section three analyses the “free perimeters”: border areas exempt of the licensing-system and with significantly lower tariffs. In effect, these areas were pockets of freer trade within a heavily protected economy; a de-facto development

instrument implemented during the thirties to compensate for the lack of integration of border towns with the rest of the economy.

Although this exercise is somewhat simple (overall trends of importation to free perimeters vis-à-vis general importation, where per-capita importation of a product significantly above the national averages signals smuggling to the rest of the country) it has not been done in the past. So this chapter brings new evidence concerning the free perimeters –and the results strongly suggest there were not minor “leakages” to the rest of the country.

5.2.- SECTION ONE –DESCRIPTIVE STATISTICS OF DOF DECREES.

The core aim of this section is to present a basic statistical picture of the built-up of protectionist barriers through the inclusion of both specific items and general categories into the list of “banned” imports (i.e., licensed). In itself, the analysis of this data brings new evidence to light and as such contributes to the wider literature of trade policy in Mexico. In terms of results, the evidence supports the claim that quantitative controls were in fact being used as protectionist devices right from the beginning, not until the late sixties as previously thought.

Specifically, this entailed the construction of a data-set based on the DOF where all new laws, decrees and amendments were published –and thus effectively enacted. As such, the SIC was obliged by law to publish in the DOF every single inclusion (as well as exclusions) into the list. Most decrees would include one item at the time; although some decrees would include dozens at once (see below).

The steps were as follows: first of all, there was the need of identifying all the decrees concerning import licensing, from its inception in 1947 until the late seventies/early eighties; a spread sheet with the relevant decrees in chronological order was thus created; then, in a second spread-sheet the items were sorted horizontally, as to have one column for each year, each column containing all the items for that year. A third spread-sheet presents the same columns but with items arranged according to the categories used by the government⁴⁸

⁴⁸ Evidently, this is subject to refinement; the boundaries are not exactly clear in some cases, for instance between manufactures and manufactured goods.

0	FOOD
1	DRINKS AND TOBACCO
2	RAW MATERIALS
3	FUEL AND LUBRICANTS
4	FATS AND OILS
5	CHEMICAL PRODUCTS
6	MANUFACTURES
7	MACHINERY & EQUIPMENT
8	MANUFACTURED GOODS
9	ARMS AND MUNITIONS

Before getting into the results, the decrees themselves have to be properly introduced as well as quantified, since they provide the first window of information into the import-licensing system.

The DOF daily issues have, on the first page, a brief “table of contents” that summarises the decrees and enactments according to the Ministry or Secretary that produced them. In the context of import licenses, this means that one decree equals at least one product, but often the decree would contain a few dozen items. Thus, the reader should bear in mind the distinction between decrees/individual products. Having said that, there is also an important caveat regarding the crucial step of converting decrees into individual items: of an aggregate of 3,754 decrees compiled, 372 of them (that is, 9.91%) either did not name the products –or naming was too vague- or the relevant pages were missing from the physical copies revised in the archives (albeit these were very few).

Table 1, below, summarises this; on a year-by-year basis, there are four years on which the missing data could substantially alter the results: 1950, 1976, 1977 and 1979. The percentage of “undisclosed/missing” over total decrees on each year is as follows: 400%, 93.55%, 150% and 487.50%, respectively. Taken by themselves, these percentages are indeed worrying; however, once in context their overall impact is negligible: compared to the first three years of decrees, 1950 does not have as many

decrees/products: in 1948 alone, 466 items were declared as banned, amongst which core industrial inputs are to be found. For the data from the seventies onwards, the cumulative nature of the process has to be taken into account (which is a core issue explained further on); that is to say, the scope for “surprises” falls dramatically as an overwhelming majority of economically relevant items were already banned from importation. Also, a not minor share of these items were chemical products clustered around a single industrial process –evidently, as the complexity of production processes rose, so the differentiation of inputs. Still, it is possible to hypothesise about the need to “not disclose” the nature of the products being banned from importation, since it could have been the case of particular favours to cronies. And even though that this possibility should remain open, it is somewhat weakened by the fact that on previous years, some odd inclusions to the list were disclosed –for instance, “dolls’ eyes”, which were neither a drain of foreign exchange nor a crucial industry for the country, were almost without doubt a rather pretty source of rents for someone with good connections.

Table 1 – Undisclosed/Not available data in DOF Decrees

YEAR	TOTAL DECREES	UNDISCLOSED / N.A	AS % of yearly total
1947	4	0	0
1948	6	0	0.00
1949	12	0	0.00
1950	9	12	400.00
1951	18	1	12.50
1952	27	4	12.50
1953	22	0	0.00
1954	29	2	7.14
1955	15	3	27.27
1956	23	5	31.25
1957	28	3	8.57
1958	32	8	16.33
1959	45	0	0.00
1960	71	0	0.00
1961	131	0	0.00
1962	107	0	0.00
1963	152	3	2.00
1964	149	7	4.93
1965	127	9	7.63
1966	75	2	2.60
1967	129	9	7.50
1968	79	5	6.85
1969	125	15	13.64
1970	293	16	6.02
1971	334	29	9.54
1972	414	36	3.25
1973	462	36	8.45
1974	560	61	12.22
1975	109	15	18.07
1976	60	29	93.55
1977	15	9	150.00
1978	21	7	53.85
1979	47	39	487.50
1980	24	7	70.00
Aggregate	3754	372	9.91

Source: author's own calculations from DOF compilations

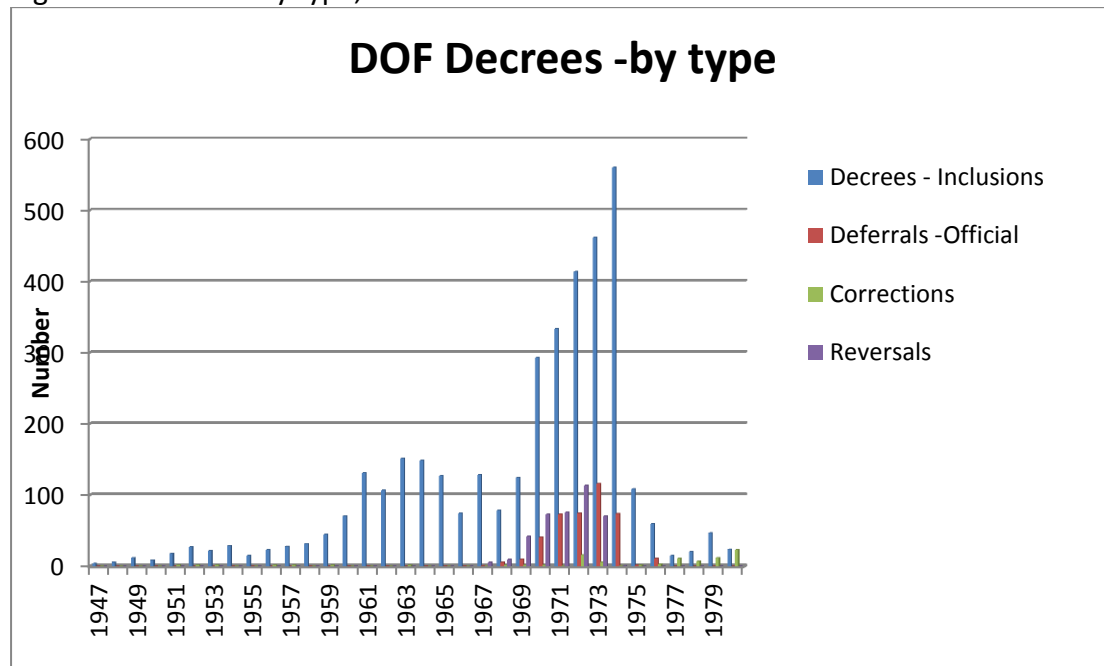
The next, relevant way of sorting the decrees is by the title or “type” attached to it: either “inclusions” (items henceforth banned from importation), “corrections” (in Spanish: *fe de erratas* that means, most of the times, misspellings or in some cases wrong items), “deferrals” (meaning that the exclusion has been deferred; that is, a *de facto* extension of protection for the particular item) , and “reversals”: those items whose importation would no longer require a permit. Thus, this last category is the closest proxy for trade liberalisation (see below).

Table 2 – Types of decrees.

Licensed Items, 1947 - 1982				
Year	Decrees - Inclusions	Deferrals -Official	Corrections	Reversals
1947	4	-	0	-
1948	6	-	0	-
1949	12	-	0	-
1950	9	-	0	-
1951	18	-	2	-
1952	27	-	2	-
1953	22	-	2	-
1954	29	-	0	-
1955	15	-	0	-
1956	23	-	2	-
1957	28	-	2	-
1958	32	-	0	-
1959	45	-	2	-
1960	71	-	0	-
1961	131	-	0	-
1962	107	-	0	-
1963	152	-	2	-
1964	149	-	0	-
1965	127	-	0	-
1966	75	-	0	-
1967	129	1	1	6
1968	79	6	2	10
1969	125	10	2	42
1970	293	41	2	73
1971	334	73	1	76
1972	414	75	16	114
1973	462	116	6	71
1974	560	74	1	1
1975	109	2	2	0
1976	60	11	3	0
1977	15	0	11	0
1978	21	0	7	0
1979	47	0	12	0
1980	24	0	23	0
Aggregate	3754	409	103	393

Source: author’s own calculations from DOF compilations

Figure 1 – Decrees by type, 1947-1980



Source: author’s own calculations from DOF compilations

As table 2 shows, out of 3,754 decrees, 409 were “corrections” –the biggest subcategory. However, many of such amendments were irrelevant and it seems to be the case that it was due to the nature of the products and the huge volume of licenses the Ministry was handling. Far more relevant and interesting are the two categories of deferrals and reversals, because they bring the issue of the *duration* of the protection. To begin with, as it is evident from table 2, these categories started only until 1967. This year marks the beginning of the *temporariness*: that is, licenses started to have a date limit –at least in theory. Back in 1947, when the licensing system was created and the first list of banned products was published, the temporary character of the measure was clearly stated, although there were no concrete dates for it to end. It is worth transcribing the “Foundational Decree”⁴⁹ for the licensing system in order to properly frame the issue of *temporariness*:

⁴⁹ DOF, 11th July, 1947.

“Decree that prohibits the importation of the items specified”.

FIRST ARTICLE: the importation of the following items is now temporarily forbidden (List of 130 items)

SECOND ARTICLE: A new entity under the name of National Commission for the Control of Imports (NCCI) is created. This commission will be formed by the heads of Ministry of the National Economy⁵⁰, the Treasury and Foreign Relations, as well as the Central Bank’s director.

THIRD ARTICLE: The NCCI will have the following faculties:

To oversee this Decree and to create the sub-commissions it considers as necessary.

To receive the contracts referred to in Articles 5th, within the specified deadlines and to resolve particular cases being presented

To receive the shipment invoices referred to in article 4th, section 1, and to resolve whether an importation permit can be issued.

If applicable, to set import quotas in accordance to Article 6th.

To establish the proportion of such quotas granted to supplying countries.

To set distribution procedures for goods under the quota system

To determine timing and extent to which the restrictions established by this decree can be lowered, taking into account the balance of payments

To establish special arrangements for items listed in this decree destined for border zones and free perimeters, as well as importation carried under exception laws.

FOURTH ARTICLE: Merchandises in transit or that have been already shipped by the time this decree is published could be brought into the country provided the following requirements are met: i) that a contract/invoice provides evidence of the order/purchasing date ii) duties are paid.

FIFTH ARTICLE: those importers should produce all the relevant documentation before August 15th.

SIXTH ARTICLE: if it is the case that the CNCI sets quotas instead of the absolute prohibition as defined by this decree, imports effectuated under article fourth will be deducted from the total set quota.

SEVENTH ARTICLE: The restrictions to importation established by this decree should not interfere with the Ministry of the Economy’s dealings with regards to foreign trade.

As it is obvious, the decree deals with a short-term challenge and the “temporarily” is not defined -what is far less obvious is that the Ministry failed to take the 130 items out of the list. Also, it should be noted that the CNCI would remain mostly as a “paper entity”⁵¹: in practice it was the Sub-secretary of Commerce, within the SIC, the body in charge of the licensing system (as stated in the next decree); in any case it would be the Treasury the closest to the process since it was in charge of tariffs. Only seven months later –the 10th February- a new decree was published, this time establishing clearer rules for the licensing:

“Article 1.- Hereby the following items are now subject to permission (of the Ministry of the Economy) in order to be imported into the country

⁵⁰ This Ministry would change its name to SIC during the next administration.

⁵¹ Thorough searches in the National Archives failed to produce substantive material: the few indirect references do show that it was more a formality than anything else.

Article 2.- The Ministry of the Economy will grant or deny the permits, which will be considered as non-transferable and will warrant, *for the time-length considered as indispensable*, the importation of the quantities deemed as essential.

Article 3.- Once a permit is granted, the Ministry of the Economy will inform the Ministry of the Treasury as for the customs to be notified and thus the importation can be effectuated.⁵² (Italics added)⁵³

Evidently, the discretion this wording would give to the Ministry was almost total. And not even ten years later, when yet another body was created to oversee and manage the importation required by the public sector and its myriad bodies (Quite ironically, such entities would prefer American suppliers over Mexican ones even if the price was slightly higher: quality and reliability were assured) that were only growing in number and diversification.

Strikingly, there is no decree to be found regarding the introduction of *temporariness* in 1966; it simply starts the 23rd of June, 1966 –that is, 18 years after the inception of the policy instrument, with a decree including ball bearings into the list and specifying that the licensing requirement would apply “up to ten years”. Hereafter (especially from 1967 onwards) decrees with *temporariness* attached would become more frequent, although a formal decree explaining the rationale for the time frame is absent –which is in itself revealing.

One possible explanation (for the sudden appearance of *temporariness*) is the pressure the Treasury would effect upon the Ministry of the Economy, given the well-known predominance, in the former, of technocrats who would be not as close to business as their peers and who would be more aware of the risks inherent to such instrument.

At any rate, the analysis of the *temporariness* confirms that it wasn't taken with much seriousness. To begin with, the statistics show that, overall, the reversals – including “expired” permits- is cancelled out by the deferrals (see table 3 below). In percentage terms, even the deferrals are slightly higher a proportion than reversals, which means that the net outcome was accumulation. And this is in best-case scenario, in which we are to believe that i) the reversals would be definitive and that ii) deferrals -its expiry date- would be made effective.

⁵² DOF: 10th of February 1948, page 2.

However, analysing the data reveals that such was not the case: many deferrals are put forward twice, even three or more times, and the decree needed for reversing the permit requirement is missing in most of the cases.

Table 3 – Official Deferrals and Reversals of import licenses, from 1967 to 1980

Year	Deferrals, as % of inclusions	Reversals, Ibid
1967	0.78%	4.65%
1968	7.59%	12.66%
1969	8.00%	33.60%
1970	13.99%	24.91%
1971	21.86%	22.75%
1972	18.12%	27.54%
1973	25.11%	15.37%
1974	13.21%	0.18%
1975	1.83%	0.00%
1976	18.33%	0.00%
1977	0.00%	0.00%
1978	0.00%	0.00%
1979	0.00%	0.00%
1980	0.00%	0.00%
Accumulated	10.90%	10.47%

Source: author's own calculations from DOF compilations

Computing the *stated* length of licensing (its expected duration, to be precise) and adding up the time for each year's total of items banned, we obtain the following results: the single year with the highest accumulated time was 1974, closely followed by 1973 and 1971, whereas the years with the highest number of expiring inclusions were 1972 and 1973. Taking the *average* length of inclusions⁵⁴, the first two years are clearly the highest: 4.96 and 5.17 years per item banned in 1966 and 1967, respectively, versus 1 for the rest of the years. This marked difference is explained by the fact that only for those years, 10-year bans were included, along with many 5-year ones. In that sense, it is clear that even in paper the government was willing to grant protection for the long run. Even if ten-year bans were not imposed after 1967

⁵⁴ It has to be noted that a minor proportion of expiring inclusions did not have the date specified, so they were left out. That is also why the total of observations in table 4 does not coincide with the total of *items* banned each year

-thus lowering the averages- it is clear from table 4 that net length of protection was being extended considerably since the late sixties and especially after 1970. This is hardly a surprising finding since it coincides with the period of Luis Echeverria's administration (1970 to 76), well-known for its efforts to "deepen" industrialisation and fostering new industries (see chapter 2).

Table 4 – Length of *temporariness* per year (years)

Year	Accumulated time	Observations	average length
1966	129	26	4.96
1967	626	121	5.17
1968	132.5	67	1.98
1969	179.6	116	1.55
1970	365.7	256	1.43
1971	494.7	311	1.59
1972	414	531.5	0.78
1973	577.9	458	1.26
1974	751.5	553	1.36
1975	167.3	128	1.31
1976	49	67	0.73
1977	9	8	1.13
1978	16.5	18	0.92
1979	59	58.5	1.01
1980	29	32.5	0.89

Source: author's own calculations from DOF compilations

An even clearer picture emerges by doing a simple exercise of extrapolating the due date of the licensing, as stated in the decrees, with the actual reversals, so as to measure the extent of un-reversed import bans. Left column of table 5 presents the accumulated number of items being classified as licensed for one year only –that is, only items due the following year, which account for roughly 60% of all. It is clear that the actual (observed) reversals are far lower than they should have been.

In other words, by 1980, the tally of reversals for one-year bans should amount to 1,377, whereas the totality of observed reversals reaches 387. That is, 990 short of its expected -strictly speaking, it is not completely accurate to subtract the OBSERVED Reversals from the EXPECTED Reversals column, since the former includes items that were banned prior to 1966. It is, again, about thinking on a best-

case scenario. Besides this point, it should be noted that, had the rest bans (2, 4 and 5 years and so on) been included, the gap would be even wider.

Table 5 – Extrapolation: expected reversals Vs. Observed reversals, year-to-year basis only

year	EXPECTED Reversals (partial measure)	OBSERVED Reversals
1968	16	10
1969	58	42
1970	138	73
1971	296	76
1972	432	114
1973	716	71
1974	1002	1
1975	1291	0
1976	1349	0
1977	1350	0
1978	1357	0
1979	1365	0
1980	1377	0

Source: author’s own calculations from DOF compilations

What these two tables show is that, even in its own terms, the instrument was deeply flawed; the almost total failure to meet its own-set goals of *temporariness* is in itself evidence that domestic producers were managing to extend the protection granted to their products; it is also evidence that using inclusions is a rather good proxy for protection: had it *not been* the case that an inclusion equalled no licenses issued (i.e., successfully getting rid of competing imports) neither the government nor the private sector would have been adamant to implement such reversals.

In sum, the clear trend of endless extensions clearly point toward rents being accrued.

Furthermore, the spread sheet also allows for a classification according to item and item type, which also brings new data to light. The total of disclosed (i.e., product’s name or description available) banned items between 1947 and 1980 amounts to 4,625. However, as shown in table 1, there are 372 undisclosed decrees of which at least half contain more than one product (it reads “others”). If it is assumed that there are two items per each such decree, it is safe to assume that 372 undisclosed

decrees equal to at least 558 items –at least, because most likely the majority of such decrees contain more than two. At any rate, the grand total is well above the five-thousand bound.

Anyhow, Table 6 below summarises the total number of undisclosed items categorized according to the government’s classification of 10 categories, whereas Table 7 presents the same data in more disaggregated fashion.

Table 6 – Summary of items banned from importation

<i>Licensed Items, total, 1947-1980</i>	
FOOD	188
DRINKS AND TOBACCO	23
RAW MATERIALS	239
FUEL AND LUBRICANTS	58
FATS AND OILS	85
CHEMICAL PRODUCTS	1172
MANUFACTURES	931
MACHINERY & EQUIPMENT	1663
MANUFACTURED GOODS	365
ARMS AND MUNITIONS	3
TOTAL	4727

Source: author’s own calculations from DOF compilation

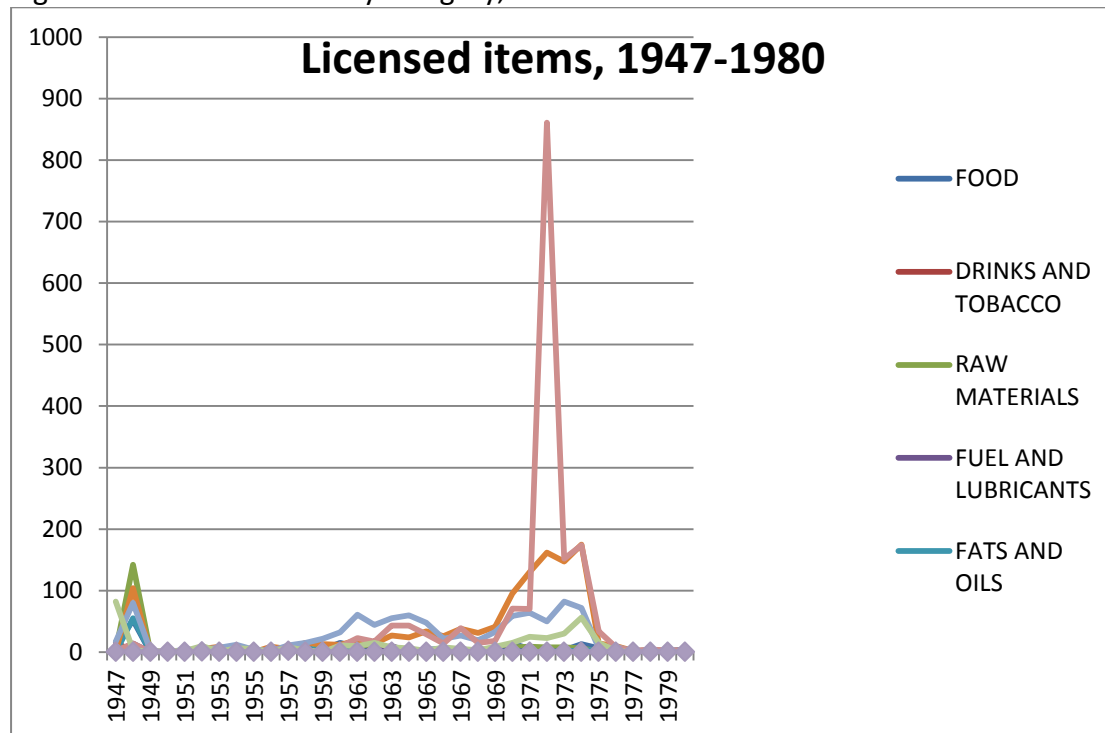
Table 7 – items per year

	FOOD	DRINKS AND TOBACCO	RAW MATERIALS	FUEL AND LUBRICANTS	FATS AND OILS	CHEMICAL PRODUCTS	MANUFACTURES	MACHINERY & EQUIPMENT	MANUFACTURED GOODS	ARMS AND MUNITIONS
1947	10	16	2	0	0	1	17	2	82	0
1948	52	0	142	14	55	104	80	14	3	0
1949	0	0	1	0	1	0	3	0	1	0
1950	0	0	0	0	0	0	0	2	1	0
1951	1	0	0	0	0	1	4	0	2	0
1952	3	1	5	1	0	5	4	2	10	1
1953	0	1	0	5	0	9	7	0	1	0
1954	2	0	5	0	0	2	12	1	6	0
1955	1	0	0	1	0	0	4	0	5	0
1956	0	0	1	0	0	9	2	4	0	0
1957	1	0	2	2	0	5	11	4	8	2
1958	2	0	3	2	8	15	15	1	3	0
1959	4	0	7	2	0	13	22	1	0	0
1960	15	0	9	1	3	12	32	9	11	0
1961	8	1	6	0	2	19	61	23	10	0
1962	9	3	2	4	0	14	44	17	15	0
1963	7	0	0	10	0	27	55	43	8	0
1964	1	0	3	1	4	24	60	43	6	0
1965	4	0	1	0	0	34	48	29	2	0
1966	5	1	1	0	0	26	22	14	8	0
1967	5	0	1	3	2	38	27	39	5	0
1968	1	0	4	0	0	31	19	15	3	0
1969	2	0	4	3	0	41	33	18	9	0
1970	14	0	8	2	2	95	59	71	15	0
1971	5	0	9	1	0	130	64	70	25	0
1972	3	0	8	0	0	162	50	861	23	0
1973	3	0	8	2	2	147	82	152	30	0
1974	13	0	6	1	2	175	72	174	56	0
1975	6	0	1	3	4	14	6	34	15	0
1976	2	0	0	0	0	10	9	8	2	0
1977	1	0	0	0	0	2	1	2	0	0
1978	2	0	0	0	0	3	4	4	0	0
1979	2	0	0	0	0	2	1	3	0	0
1980	4	0	0	0	0	2	1	3	0	0

Source: author's own calculations from DOF compilations

Figure 2 shows the inclusions into each broad category by year; this way it is clear that there are two main peaks: that of 1948 and the subsequent and far larger of 1971-75, particularly 1974 for machinery and equipment, which are obviously out of proportion compared with the rest of the categories. This only confirms the over-reliance of trade policy for industrialisation purposes.

Figure 2 – Licensed Items by category, 1947-1980

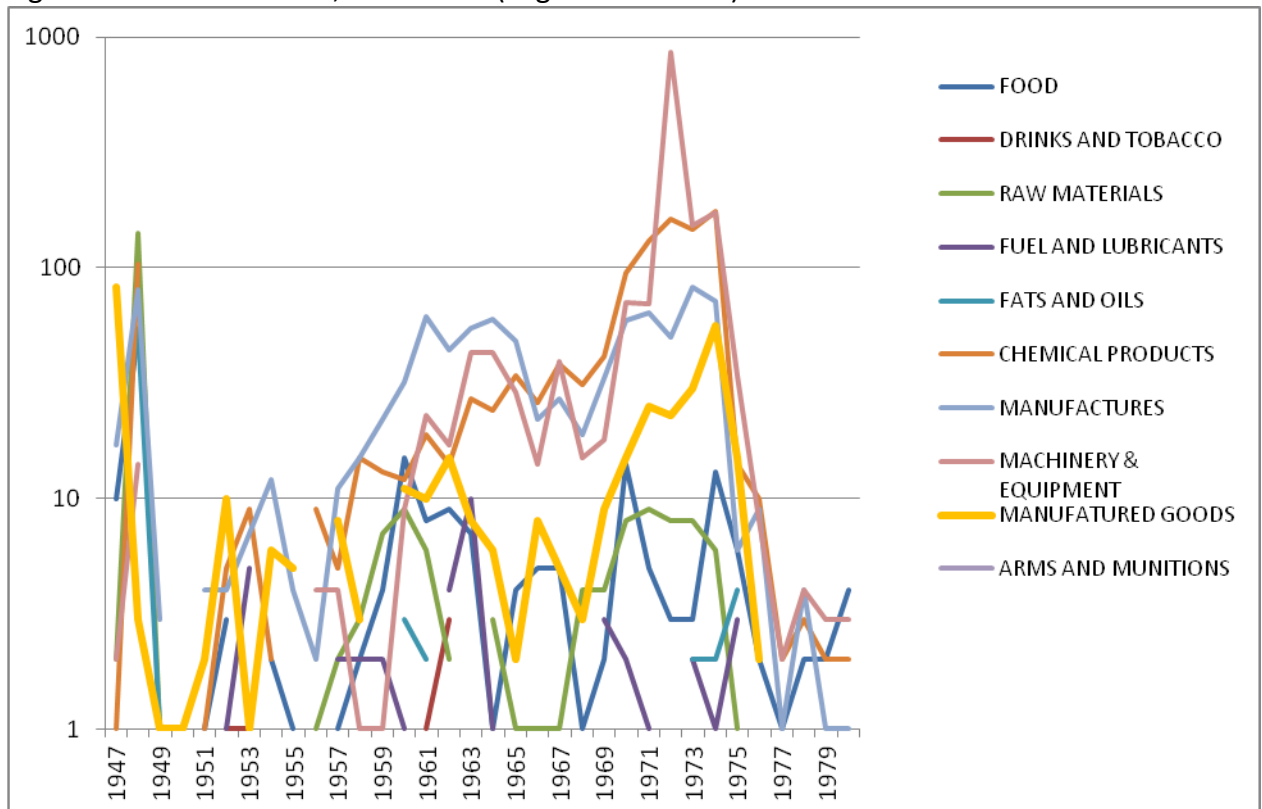


Source: author's own calculations from DOF compilations

The same data presented in LOGS -figure 3, below- makes the relative position of each category and the magnitude of the trends over time somewhat clearer; it is now possible to note that the trend in manufactures closely follows that of machinery and equipment, except for the 1974 peak. This makes perfect sense since items included in the latter category would be used to produce inputs for other industries: again, part of the efforts to “depeen” ISI during the Echeverria administration. In that sense, it is clear evidence of the priority given to producers. Even more so once the green line –raw materials- is considered: it remained strikingly low althroughout the period, never even reaching the 10 inclusions-per-year bound. This clearly means that the government kept the borders (relatively) open to crucial inputs, therefore keeping producers’ cost low.

it is also evident that both chemical products and manufactured goods followed a very similar upward trend; although the magnitude is not the same, the direction follows that of machinery and equipment. This can easily be interpreted as a natural consequence of the “internal logic” of import-substitution: as it reaches both intermediate and capital goods, even more items (components) have to be excluded, otherwise the process would have reached a dead-end.

Figure 3 – Licensed Items, 1947-1980 (Logarithmic scale)



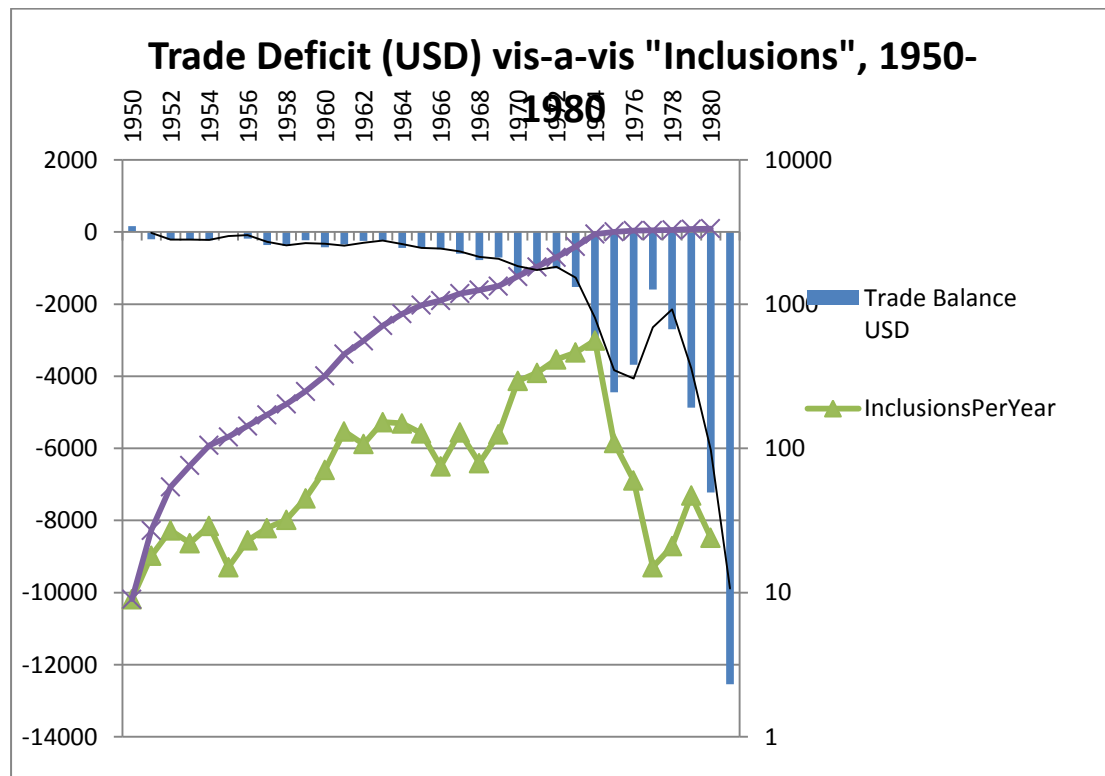
Source: author’s own calculations from DOF compilations

Another relevant comparison is that of inclusions (adjusted for the 393 reversals that took place between 1967 and 1964) both expressed as “flow”-annual inclusions- and “stock” –accumulated total- vis-à-vis the trade deficit and, also, the openness to trade, expressed as $[(Exports - Imports)/RGDP]$.

Figure 4 below shows the trade deficit on the left axis –million UD dollars- whereas the right axis, in Logarithmic scale, presents the number of inclusions into the list of licensed items. It is strikingly clear that most of the growth in inclusions took place

throughout the period of contained trade deficit: even the yearly number declines only after 1974.

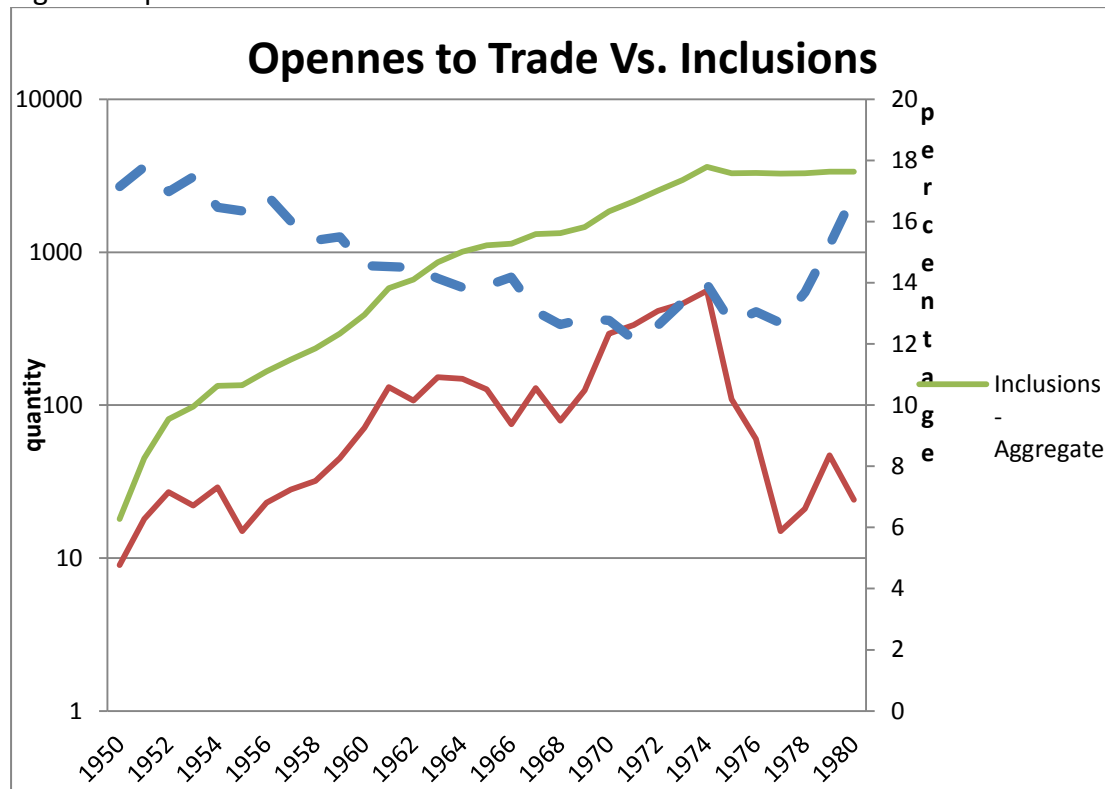
Figure 4 – Trade Deficit (USD) vis-à-vis “Inclusions”, 1950-1980



Source: BANXICO (trade deficit); author’s own calculations from DOF compilations (Inclusions per year, Inclusions –aggregate)

As expected, the correlation of inclusions with Openness to trade –Figure 5- is negative in an almost perfect fashion. At first, this may seem pretty obvious since in theory it should be a “mirror” image. However, it could have been the case that particular items were “banned” only to grant many permits, thus neutralizing to some extent the protectionist device. In that sense, figure 5 confirms, for the second time, that “inclusions” is a good proxy for protectionism: they effectively translated into less imports, *relative to size of the economy*.

Figure 5 Openness to trade Vs. Inclusions.



Source: Banco de Mexico and Penn Tables (Openness to trade); author's own calculations from DOF compilations (Inclusions)

5.3- SECTION TWO – A SAMPLE ON THE MISMATCH

This section aims to present a rough estimate of the size of the smuggling at the macro level. The assumption is rather simple: if American exports to Mexico as reported by the US government are lower than the American imports as reported by the Mexican government, then the “gap” or missing value equals the value of merchandise illegally introduced into the country. Of course, such missing value is not rent: the real number for the pure rent should be derived as the difference between the price paid in the US and the price at which it was sold in Mexico, minus transport and bribery costs –and not taking into account the long-term costs associated with diverting resources, including human capital, to smuggling.

The exercise, though, is not merely one from theoretical considerations: it was a real issue right from the establishment of the licensing system, as the following piece of evidence –already discussed in Chapter Three- clearly shows; it is a letter sent to the Mexican President by Ernest Falk, manager of Northwest Horticultural Council, located in Yakima, Washington. It is dated October 8, 1953, and one of the paragraphs is the following:

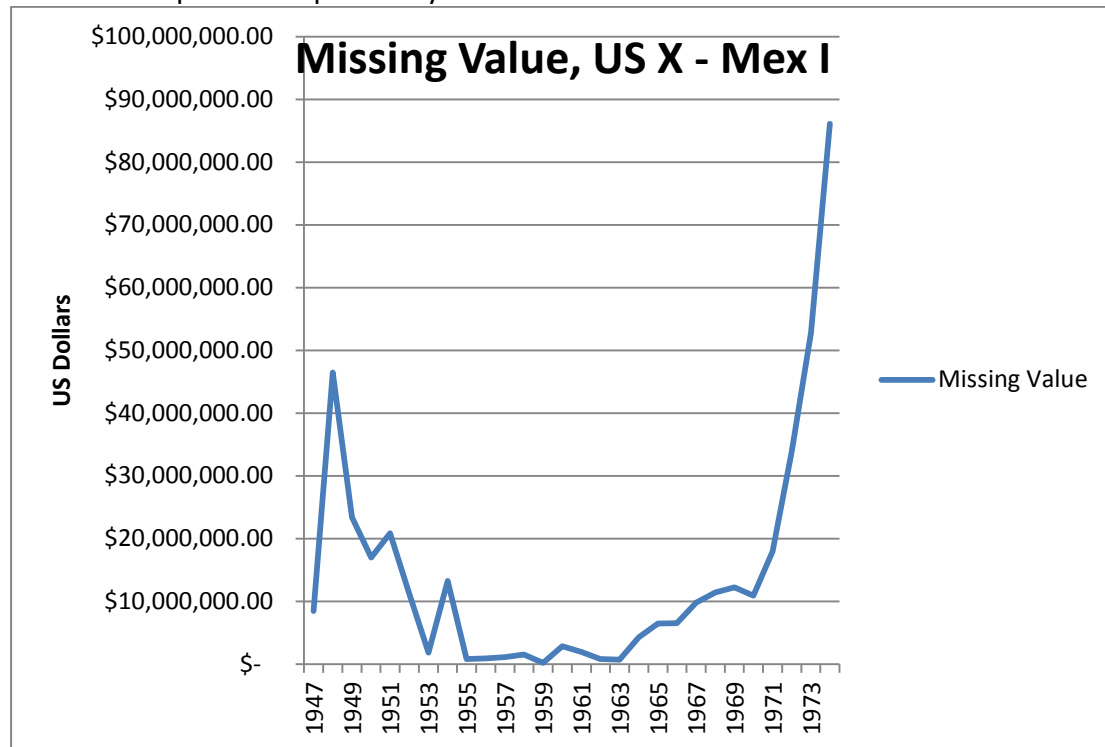
(...) We are vitally interested in exporting apples and pears to Mexico. During the 1945, 1946 and 1947 seasons, we annually exported to your country approximately 225,000 boxes of apples and 35,000 boxes of pears. This volume was sharply reduced in 1948 when, we understand, artificial barriers were erected by the Mexican government and importation of fruits either prohibited or sharply restricted through the granting of licenses. At the same time, members of our trade noticed a diversion from firms previously in the import business to newcomers. We also note that the volume of exports as reported in the import business by the United States Office of Foreign Agricultural Relations was *substantially greater* than the volume reported by the Department of commerce which is based its reports on your Government’s import figures.⁵⁵

In order to make the comparison between US and Mexican figures, the data expressed as imports, which is on Mexican current pesos, was converted into current dollars; therefore, it is current dollars but given that the comparison is made every year there is no need of using current dollars –at least for the purpose of detecting the “gap”.

⁵⁵ ARC: 998/564.2/347

The first and most important overall finding is that, as a matter of fact, the gap is positive for all years from 1947 to 1974 –i.e., imports from the US as reported by Mexico are consistently lower than American exports to Mexico as reported by US- The absolute values are shown in Figure 6 below:

Figure 6 –Missing Value – American Exports to Mexico as reported from US vs. American Imports as reported by Mexico



Source: author’s own calculations from DOF compilations

It is clear from Figure 6 that there is a marked increase right at the beginning of the licensing system, in 1947, when it amounted to 8.4 million dollars: the following year it jumped to 48 million. That peak wouldn’t be surpassed until 1973. Throughout the fifties and sixties it apparently flattened substantially, only to go up very fast during the seventies. This overall U-shaped trend can be somewhat puzzling, but the data has to be controlled for the size of the total trade flow. Table 8, below, presents the data relative to the size of total US exports to Mexico:

Table 8

Year	Percentage of total X
1947	1.34%
1948	8.92%
1949	5.00%
1950	3.32%
1951	2.92%
1952	1.68%
1953	0.28%
1954	2.11%
1955	0.12%
1956	0.11%
1957	0.12%
1958	0.18%
1959	0.03%
1960	0.35%
1961	0.24%
1962	0.10%
1963	0.08%
1964	0.40%
1965	0.59%
1966	0.59%
1967	0.80%
1968	0.83%
1969	0.84%
1970	0.64%
1971	1.06%
1972	1.71%
1973	1.80%
1974	1.77%

Source: author's own calculations based on AEEUM and trade statistics from US Department of Commerce.

In percentage terms, the trend is less puzzling: the first four years it goes from 1.34%, then jumps to and peaks at 8.92 only to fall to 5% and 3.32% in 1949 and 1950 respectively. Then it certainly flattens and remains below 1 per cent for most of the period; it is until the seventies when peaks again, but in relative terms it would never reach the same levels.

It certainly makes sense that smuggling peaked during the first years since there were a number of elements playing against the effective implementation of trade controls: first of all, the sudden absence of some products in some markets would set the incentives for (illegally) keeping the supply of them; the under-staffed, poorly paid custom officials would be easily bribed, and even well-intentioned custom

officials would find it daunting to distinguish different items when it came to, say, ferrous and non-ferrous metals, chemical products and the like.

In fact, looking at the average distribution of the missing value over the period, the following ranking is to be found⁵⁶:

Table 9

Highest average percentage difference	
Fruit and vegetables	88.12%
Metal ferrous	86.65%
Dairy products and eggs	46.96%
Meat	42.20%
Chemical elements and compounds	41.90%
Textile fibres	40.73%
Manufactures of metal, NES	35.64%
Oils total	23.41%

Source: author's own calculations based on AEEUM and trade statistics from US Department of Commerce.

Interestingly and coincidentally enough, this validates Mr Falk's complaints about the smuggling in the fruit and vegetables industry; moreover, it shows the relatively high share of consumables: fruit, vegetables, meat, dairy products and eggs (also discussed in chapter three). This would be a chronic problem since not only prices of American consumables were consistently lower than Mexican ones but also because some American firms would dump produce whose quality did not fulfil government standards –the Mexican egg industry would repeatedly complain about this.

The rest of the categories are, alas, crucial industrial inputs: metal-ferrous materials, chemical elements and compounds, textile fibres and oils. These smuggled materials would clearly give some firms the sort of "rising-rivals'-costs" rents that were already discussed in chapter three.

Going back to the overall trend –that of decline and stabilization of the figure for smuggling- the question, of course, is whether the government really managed to crack down on corruption; the issue was particularly relevant for the Treasury since it meant loss of revenue. However, specific policies and campaigns targeting

⁵⁶ These figures should be taken very carefully since the categories are not strictly entirely comparable, and two big categories (unspecified and special items) are not included. Therefore the table aims to be of indicative nature only.

smuggling were only systematically implemented until the sixties, and the fall from 8 per cent in 1948 to 2.9 in 1951 seems somewhat too fast.

A different, more plausible hypothesis is that the “free-perimeters” along the northern border would provide an even easier way to get access to imports and then re-sell them. That is precisely the focus of the next section.

5.4.- SECTION THREE - THE FREE PERIMETERS (FP): DEVELOPMENT INSTRUMENT OR A GRACIOUS BENEFIT?

The “Free Perimeters” or free-trade areas across the border were first created in 1933, after the lift of the alcohol prohibition in the US. Along with prohibition had come, for Mexican border towns, a significant pull for economic activity since they would attract American citizens with cheap alcohol (as well as prostitution, gambling and other less glamorous vices). The impact this pull-effect had in the area is even higher once it is considered that the majority of such border towns did have neither good transport links (if any) nor any significant industries –hence, such towns quickly became heavily dependent on the thirsty *gringos* crossing the border.

Once this source of economic activity dried up, the pressure for the government to substitute it, or at least to some extent compensate for its loss, started increasing. However, the federal government knew that it would take a long time to create industries big enough as to become a reliable source of employment; instead, it opted for a second-best solution of ensuring that the cost of life would remain low, by granting access to tariff-free imports. Thus, the first free perimeters were created in 1933 around the border cities of Tijuana and Ensenada, subsequently expanded in 1938 and 1939 (by then the first ones in the south border were created). Initially, the “exception” would include virtually all imports; however, as the FP gained momentum the Treasury would permanently adjust the tariffs to be paid for on the most popular items.

It should be noted that the FP were an immediate success, to the extent that, after WWII, there were many cities effectively competing with each other for becoming a free zone (“*zona libre*”). In fact, in the personal archives of President Miguel Aleman Valdes (1946-1952) this researcher found reference to almost 20 letters from either

governors or majors in different regions seeking to be granted with such entitlement. However, in this respect the government was careful enough not to give too many concessions since it would have obviously hampered the protectionist efforts that were at the core of economic policy.

As it was explained by Francisco Alcala, Sub-Secretary of Tax Revenue⁵⁷, (part of the SHCP)

“Later on, in august 1938 the government created the special zones in Sonora and, 1939, in Baja California. The decree (policy) establishing such free zones had as main objective to raise population growth in these areas, granting permission to acquire goods and basic staples on the other side of the border. It is also a policy intended to foster economic development by supporting primary and secondary economic activities with favourable fiscal conditions and by stimulating the production of export manufactures and, overall, to improve living standards in the region.

I would like to reiterate the government’s claim that free perimeters are not, in any way, a *gracious privilege* but rather a fiscal device for social and economic development so the region can integrate itself with the rest of the country. Also, I would like to add that the free perimeters will be maintained as long as the government thinks of it as a useful mean to achieve the goals aforementioned.” (Italics added)

As it is clear from the defensive tone –and the denial of it being a “gracious privilege”- the government had to justify itself mainly in two fronts: it had to defend the free perimeters policy against claims by some actors within the private sector that smuggling had reached unacceptably high levels and, second, that the policy was in fact detrimental to many domestic industries since such border towns would barely consume national products.

The latter had become a political problem to the extent that, by late sixties, a programme entitled “Economic March toward the Border” was implemented by the Federal government. It consisted of two elements: i) tax breaks for firms selling goods anywhere in the border, and ii) subsidies between 25% and 50% for transportation, either by train, ship or plane.

To the first claim, the Ministry would point out that population growth in the region was in the neighbourhood of 10% a year, that is three times the national average;

⁵⁷ Comercio Exterior: vol. xix num. 12 dic. 1969

total investment went from 65 million pesos in 1945 to 1,400 million in 1965, and the total payroll increased from 25 million to 209 in the same period (Ibid). In other words, the government did not see anything abnormal in the soaring numbers for importation to the FP. Regarding the second point, the Sub-secretary wrote:

“Taking into account such policies (the “March toward the Border”) there is still the question of why has importation to the free perimeters increased at such a high pace. The Committee for economic development in the North Border area has done research that shows that 84% of families in the major cities regularly buy goods in the US side of the border. 90% of them agreed with the claim that prices are cheaper, whereas 65% agreed with the claim of superior quality [...] these are objective considerations, not psychological preferences. Therefore, their behaviour cannot be labelled –as it is so frequently done- as “*malinchista*”⁵⁸; it must be considered simply as rational. Such results clearly delineate the strategy to cope with the challenge of the border area: the tax breaks and subsidies must be matched with an increased and diversified supply of products. As long the price and quality disparities remain, the March will have little impact.”

Of course, the Treasury wouldn’t deny the existence of smuggling –in fact, the first official measure was implemented by 1968- but the diagnosis of the problem was far from being as dire as it was in the private sector.

For instance, in the yearly reports of the Banco Nacional de Mexico, the biggest private bank in the country, the topic is discussed at large. The 1970 report⁵⁹ contains the following analysis with respect to the “Harmful smuggling” carried from the free perimeters:

“The official mechanism which has done most favour to our industrialisation is protectionism, by which the frontier is closed to many goods whose competition would eliminate the companies here. However, the great use of import controls has nurtured the growth of an important and destructive activity: smuggling, either on a great scale organized by retail or *fayuca*⁶⁰. The former is calculated at some 400 million dollars each year. It is impossible to estimate the latter.

⁵⁸ This term, the exact opposite of chauvinist, has very negative connotations. By the time it was used in the papers to condemn the preference for American goods, in detriment of the “National Industry”.

⁵⁹ Review of the Economic Situation of Mexico (RESM). Vol. XLVI No 50, Nov, 1970, pp 285-286

⁶⁰ This word was widely used to designate merchandise illegally introduced into the country.

The greatest volume of smuggling occurs along the border, where all kinds of products from abroad arrive. In the interior, the most common thing is the illegal entry of wines and liquors which can be obtained without a label at a price half of that paid for legally imported bottles. The success of this line is due to the fact that the principal liquors are made in Mexico but not at the same level of quality as the foreign product.

Other important goods are clothing, personal articles and electrical items. It is also possible to acquire many other goods and even motor cars. To the flight of foreign exchange and to the damage this does to industry and commerce may be added the loss of the treasury.

The minister of the Treasury has indicated recently that "smuggling is an indicator of the quality of our products". But he also made reference to the psychological aspect of preference for imported goods in saying: "commerce must fight against the inferiority complexes of the buyers without losing sight of the fact that smuggling is a theft committed against the labour of our children".

Putting an end to smuggling is the task of all the sectors: the government in its direct campaign; private individuals by ceasing to buy. It could also be the special treatment of us authorities.

Even some industrialists are disposed to accepting imports of certain goods that are made here, with a moderated duty to be paid as a way of combating smuggling and of stimulating companies to improve their production." (RESM, 1970:286).

Interestingly, this point –whether growth in imports to the FP followed a "natural" pattern of not- has never been properly tested in the literature. The hypothesis here, as it has been already stated in the introduction, is precisely the opposite of Mr Alcalá's claims: Free perimeters were in fact used as a source of cheaper imports that would be smuggled into the country. It follows exactly the same logic: a rational entrepreneur will simply solve this simple equation: how many kilometres into the country does the price difference can afford?

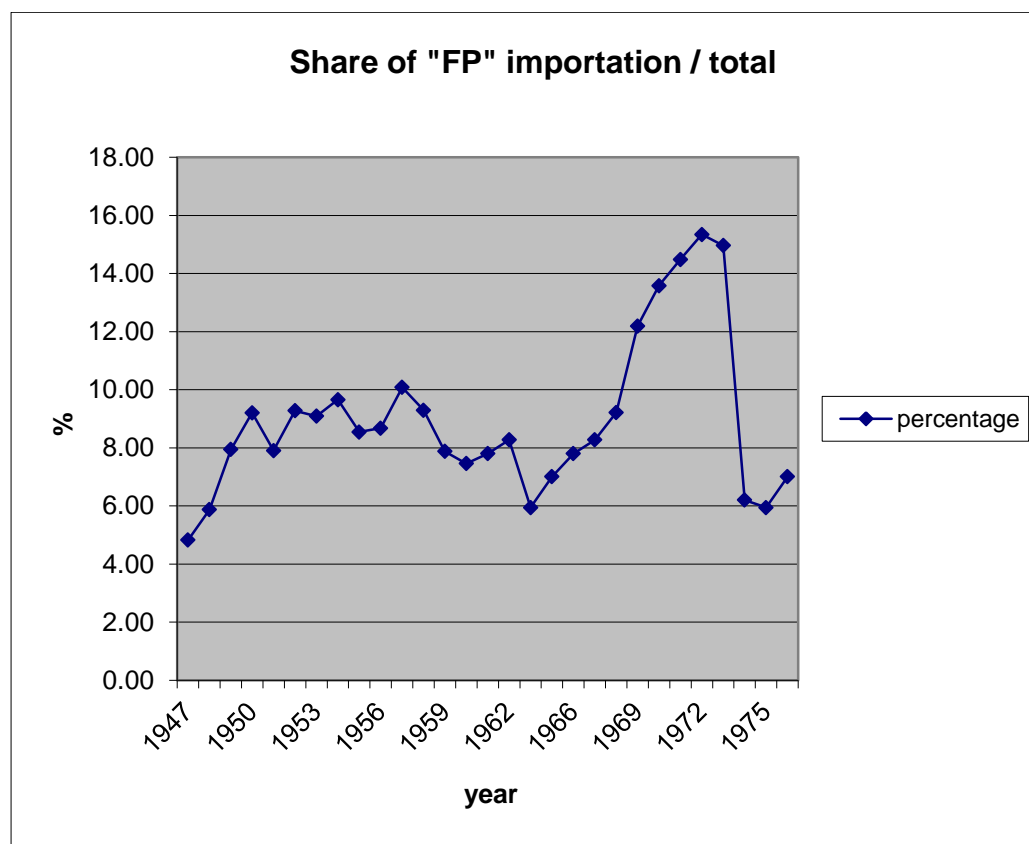
There are a number of ways to empirically approach the question of whether importation to free perimeters followed a "natural" pattern or were being used to divert imports; the core test of this section consists in converting the data on imports to the free perimeters to *per capita* terms and then comparing it with the per capita "general" importation. Evidently, the core caveat of this approach is that the availability of Mexican goods in border towns was by definition lower than in Mexico City (the capital). In other words, while in border towns consumption almost equalled importation, which was not necessarily the case for the rest of the country.

Therefore, comparing per capita importation in free perimeters vis-à-vis per capita importation in the rest of the country has an inherent upward bias: substitution effects are not the same.

Nonetheless, the test still is meaningful for a number of reasons: if *magnitudes* are not only significant but consistent *across different items and time* and if such trend also shows up in growth rates (vis-à-vis both population and general importation) then it is reasonable to conclude that free perimeters were being used as a precious source of rents.

Starting with the most general facts, Figure 7 presents Importation to free perimeters as a share of total importation. Three phases are clearly distinguishable: there is a steep increase from the inception of the licensing system in 1947 to 1950, when it almost reached 10 per cent; from then until 1963 it fluctuates around 8 (+/- 2) percentage points, while between 1963 and 1973 it grows steadily to peak at 15.34 per cent in 1973. The steepness of the 10-year growth is all the more suspicious once it is considered that inputs for *maquiladoras* (manufacturing plants along the border) are not accounted for on these statistics –which would be one of the best potential explanations.

Figure 7

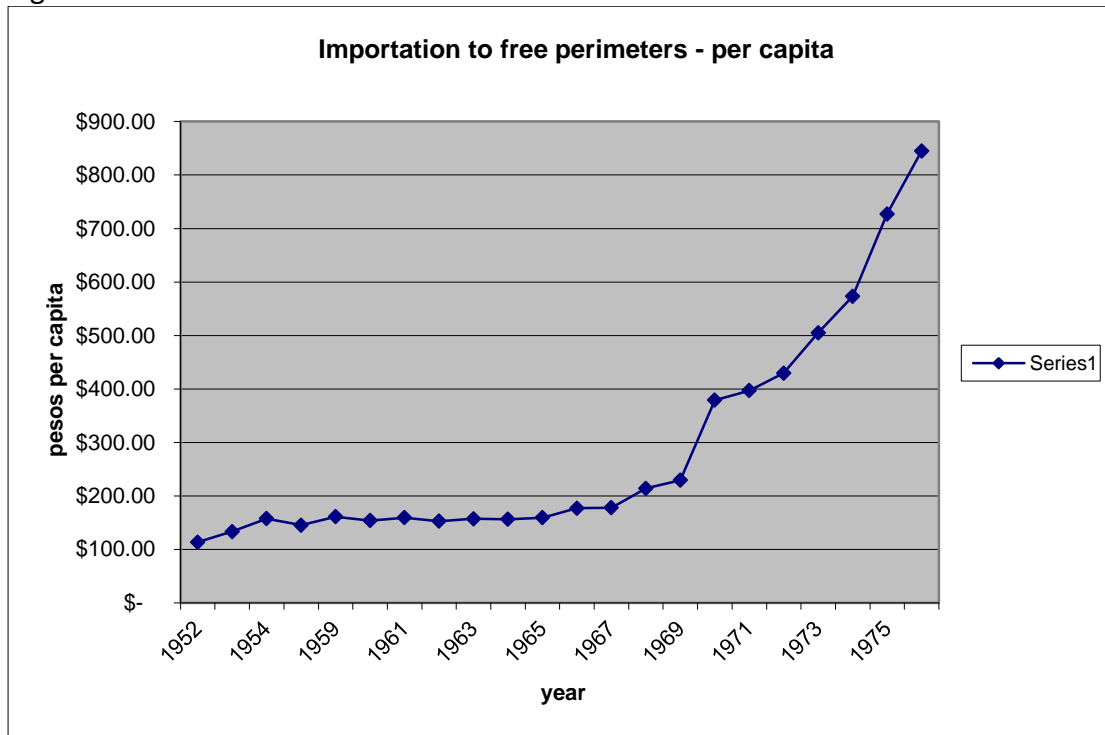


Source: Author's own calculations based on the *Anuarios Estadísticos*

The picture becomes even more staggering once the importation to free perimeters is controlled for population –and it should be noted that the figures used in this test are the ones for the whole state where the free perimeter was, as opposed to the population of the urban areas only⁶¹ (where most of the consumption took place). Again, the evident *steepness* of the trend makes the claim of it being “natural” growth practically impossible: from \$100 pesos per capita in 1952, to \$200 in 1969 to almost \$900 in 1975? Such pace would require a four-fold increase in GDP per capita in 6 years, which was clearly not the case.

⁶¹ It is also convenient to have the downward bias of a larger population since the calculation was made using current pesos; in any case, this was precisely the more price-stable period of recent history, with inflation consistently at 3 per cent.

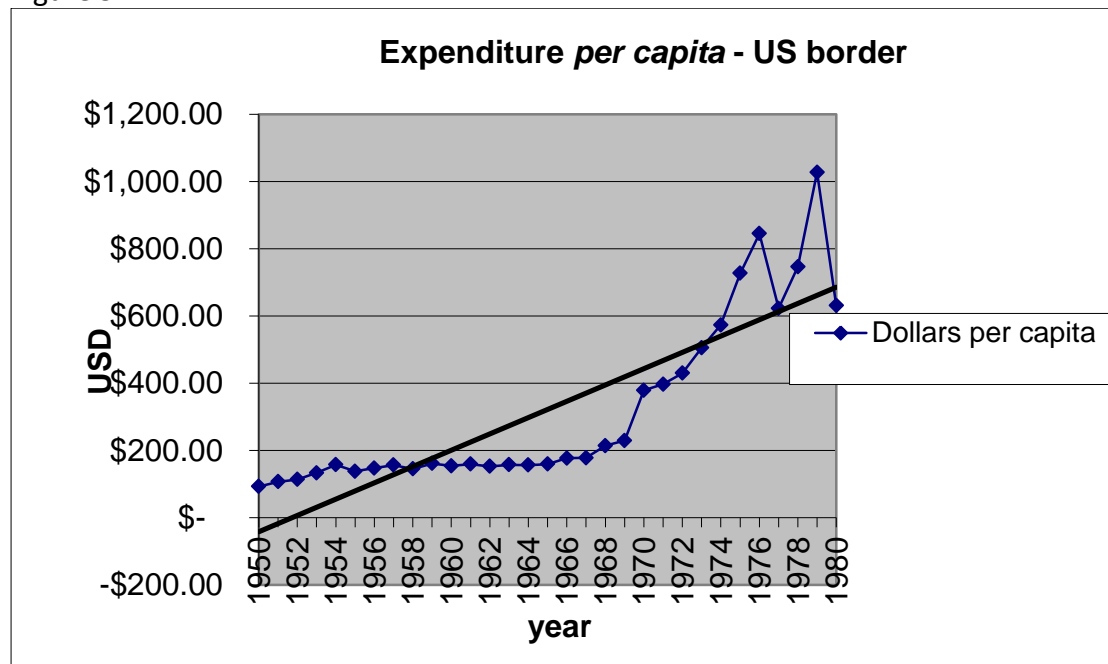
Figure 8



Source: author's own calculations based on the Anuarios Estadísticos.

The same trend is confirmed by a monetary approach: converting the dollars spent in the border (on American goods) into per capita terms only confirms the same trend already described.

Figure 9



Source: author's own calculations based on Banco de Mexico data for Balance of Payments

Furthermore, the *compounded growth rate* of importation to the free perimeters, for the period 1947-1976 is not only very high, but above the same rate calculated for general importation. The free perimeters CGR of 13.30% is almost twice as high as the CGR in general importation.

Table 10

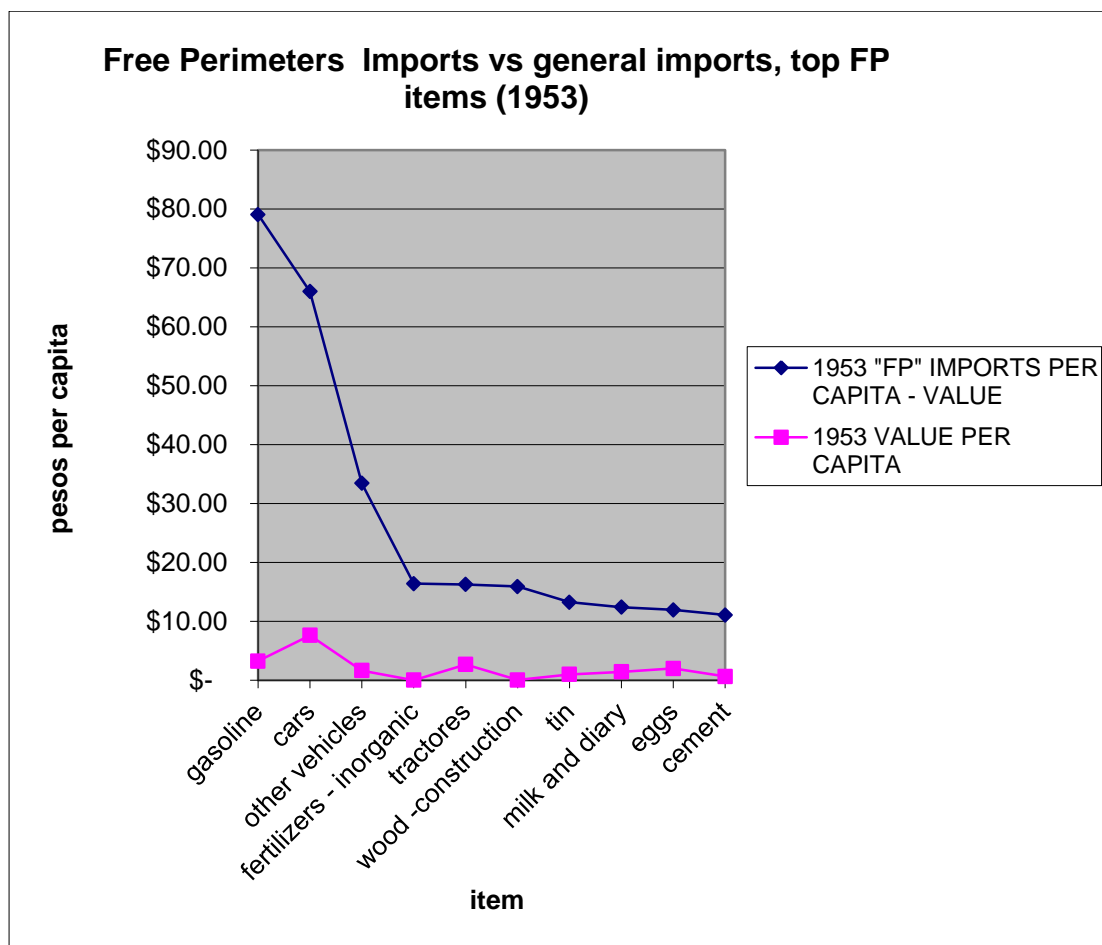
importation to free perimeters		total importation - pesos		total importation - USD
COMPOUNDED GROWTH RATE		COMPOUNDED GROWTH RATE		COMPOUNDED GROWTH RATE
13.30%		12.01%		7.13%

Source: Author's own calculations based on the *Anuarios Estadísticos* and statistics from the US department of commerce.

In order to compare between the free perimeters and the general importation, the data was not only converted into per capita terms: *rankings* were also calculated for both categories. This way, the top-ten imported items (value-wise) in the free-perimeters are compared against the same products imported to the rest of the country –it does not matter that the rankings are not the same for general importation as long as the products are the same.

Figure 10, below, presents a “typical” year (1953) in which the gap between the two is evident: the distance between the value of the importation of the top ten is almost ten-fold –even if gasoline, where the substitution effect makes the comparison very problematic, is taken out, the trend still holds even beyond the top-ten bound.

Figure 10



Source: author's own calculations based on the Anuarios Estadisticos.

As table 11 and 12, and figure 11 and 12 below show, the trend is remarkably constant not only across different items but also across time. In fact, the only exception was machinery (see figure 12), most likely explained by the fact that capital goods are the most expensive and because most of the industry was located in the centre of the country.

Table 11

	1951	Rest of the country		FREE PERIMETERS
cars	\$	11.73	\$	59.30
gasoline	\$	1.57	\$	42.79
vehicles -other than cars	\$	0.65	\$	31.41
tractors	\$	5.22	\$	22.15
insecticidas	\$	3.67	\$	17.53
wood -construction	\$	0.18	\$	16.05
spare parts	\$	9.88	\$	14.53
tin	\$	1.04	\$	13.63
wheat	\$	8.73	\$	11.48
	1952	1952 VALUE PER CAPITA		FREE PERIMETERS
cars	\$	9.92	\$	55.55
gasoline	\$	2.32	\$	38.99
vehicles -other than cars	\$	0.87	\$	35.55
lard	\$	0.93	\$	27.72
tractors	\$	2.22	\$	17.00
insecticidas	\$	2.03	\$	15.67
petroleum	\$	0.73	\$	12.95
wood -construction	\$	0.20	\$	9.97
tin	\$	0.87	\$	9.39
	1953	1953 VALUE PER CAPITA		FREE PERIMETERS
gas	\$	3.23	\$	79.07
cars	\$	7.59	\$	65.98
spare parts (planes)	\$	1.61	\$	33.43
electricity	\$	-	\$	16.38
milk	\$	2.66	\$	16.23
gas-oil	\$	0.01	\$	15.88
fertilizers	\$	0.97	\$	13.24
lubricant oil	\$	1.41	\$	12.39
tractors	\$	1.97	\$	11.92
natural gas	\$	0.61	\$	11.04
	1954	1955 VALUE PER CAPITA		FREE PERIMETERS
Gasoline	\$	8.24	\$	92.60
cars	\$	2.87	\$	74.07
fertilizers - inorganic	\$	11.11	\$	39.06
vehicles (transport)	\$	22.22	\$	37.46
tractors	\$	7.14	\$	35.50
wood	\$	0.37	\$	23.53
milk and diary	\$	0.56	\$	18.73
tin	\$	0.38	\$	18.70
air pumps & devices	\$	0.12	\$	2.81
eggs	\$	1.31	\$	16.86

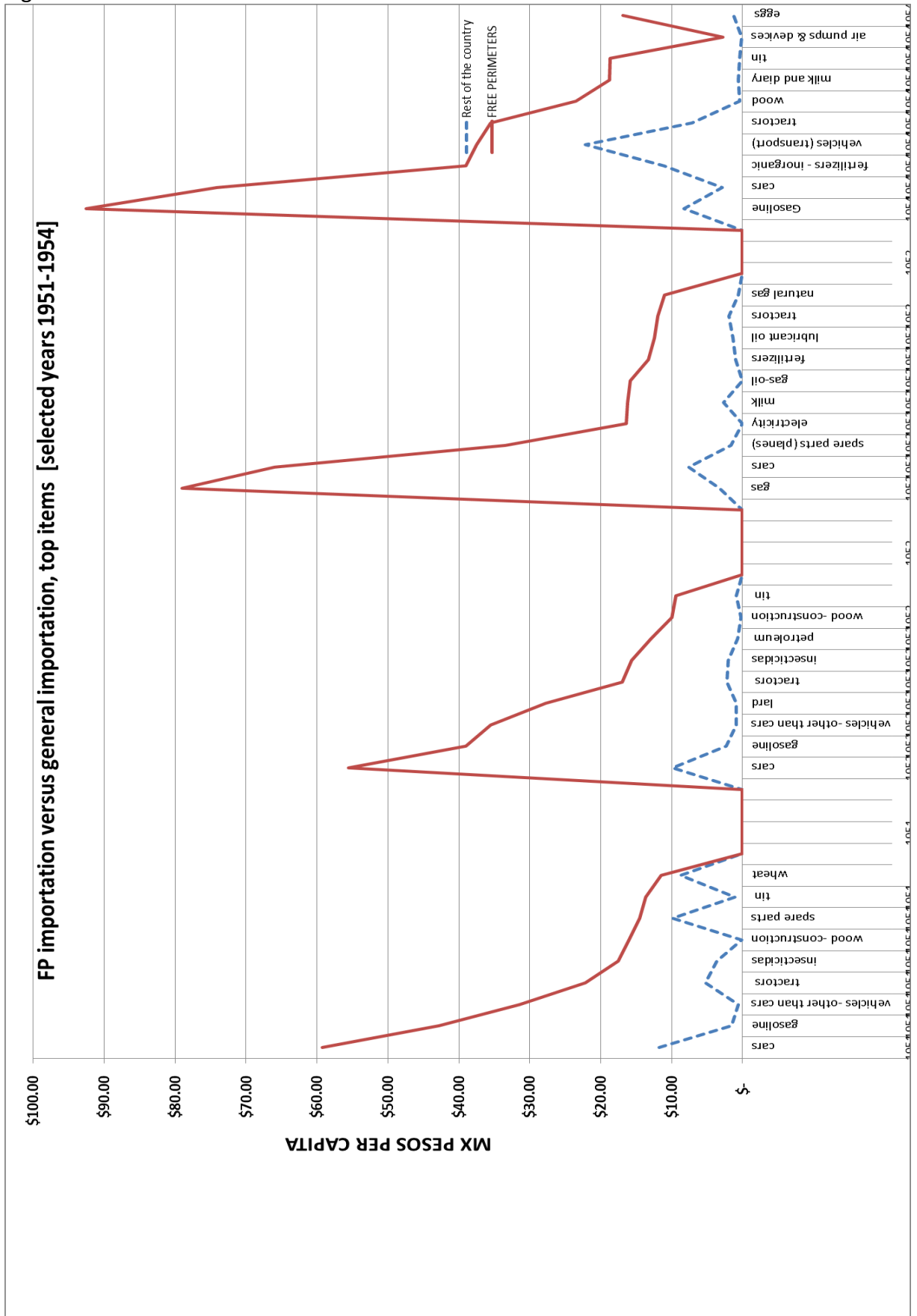
Source: author's own calculations using AEEUM statistics

Table 12

	PER CAPITA FP VALUE	PER CAPITA TOTAL IMP
vehicles	\$ 121.93	\$ 40.66
machinery	\$ 95.47	\$ 107.80
iron and steel	\$ 77.22	\$ 17.71
petroleum	\$ 62.14	\$ 9.85
machinery (electric)	\$ 41.15	\$ 31.10
clothing	\$ 47.77	\$ 2.18
celulose	\$ 32.35	\$ 2.91
plastic materials	\$ 20.72	\$ 10.67
oils	\$ 20.25	\$ 1.62
instruments	\$ 18.96	\$ 11.49
other	\$ 17.84	\$ 53.93
	PER CAPITA FP VALUE	PER CAPITA TOTAL IMP.
OTHER	\$ 135.40	\$ 58.61
cars and trucks	\$ 105.81	\$ 39.99
machinery	\$ 102.66	\$ 115.95
petroleum	\$ 83.46	\$ 10.10
electric machinery	\$ 74.92	\$ 39.90
iron & steel	\$ 71.73	\$ 7.46
clothing	\$ 67.35	\$ 2.75
cars	\$ 56.52	\$ 0.64
transport equipment	\$ 26.07	\$ 1.05
milk	\$ 22.21	\$ 3.31
spare parts - trns	\$ 21.61	\$ 10.71
celulose	\$ 19.68	\$ 4.07
1968	PER CAPITA FP VALUE	PER CAPITA TOTAL IMP.
OTHER	\$ 174.34	76.76896731
electric machinery	\$ 158.75	\$ 47.29
cars and trucks	\$ 104.33	\$ 43.66
machinery	\$ 96.74	\$ 116.76
clothing	\$ 89.93	\$ 1.00
iron & steel	\$ 82.61	\$ 16.34
petroleum	\$ 57.09	\$ 9.74
cars	\$ 55.09	\$ 0.78
toys	\$ 48.27	\$ -
celulose	\$ 27.07	\$ 3.75
spare parts	\$ 26.05	\$ 10.80
milk	\$ 25.68	\$ 1.48
1969	PER CAPITA FP VALUE	PER CAPITA TOTAL IMP.
OTHER	\$ 181.33	\$ 41.12
electric machinery	\$ 175.52	\$ 41.12
cars and trucks	\$ 109.20	\$ 43.74
clothing	\$ 91.00	\$ 1.97
machinery	\$ 95.20	\$ 124.24
iron and steel	\$ 84.36	\$ 5.06
petroleum	\$ 59.36	\$ 11.13
juguetes	\$ 42.98	\$ -
cars	\$ 57.74	\$ 0.79
celulose	\$ 29.69	\$ 5.37
plastic materials	\$ 31.78	\$ 8.81
milk	\$ 24.57	\$ 1.53

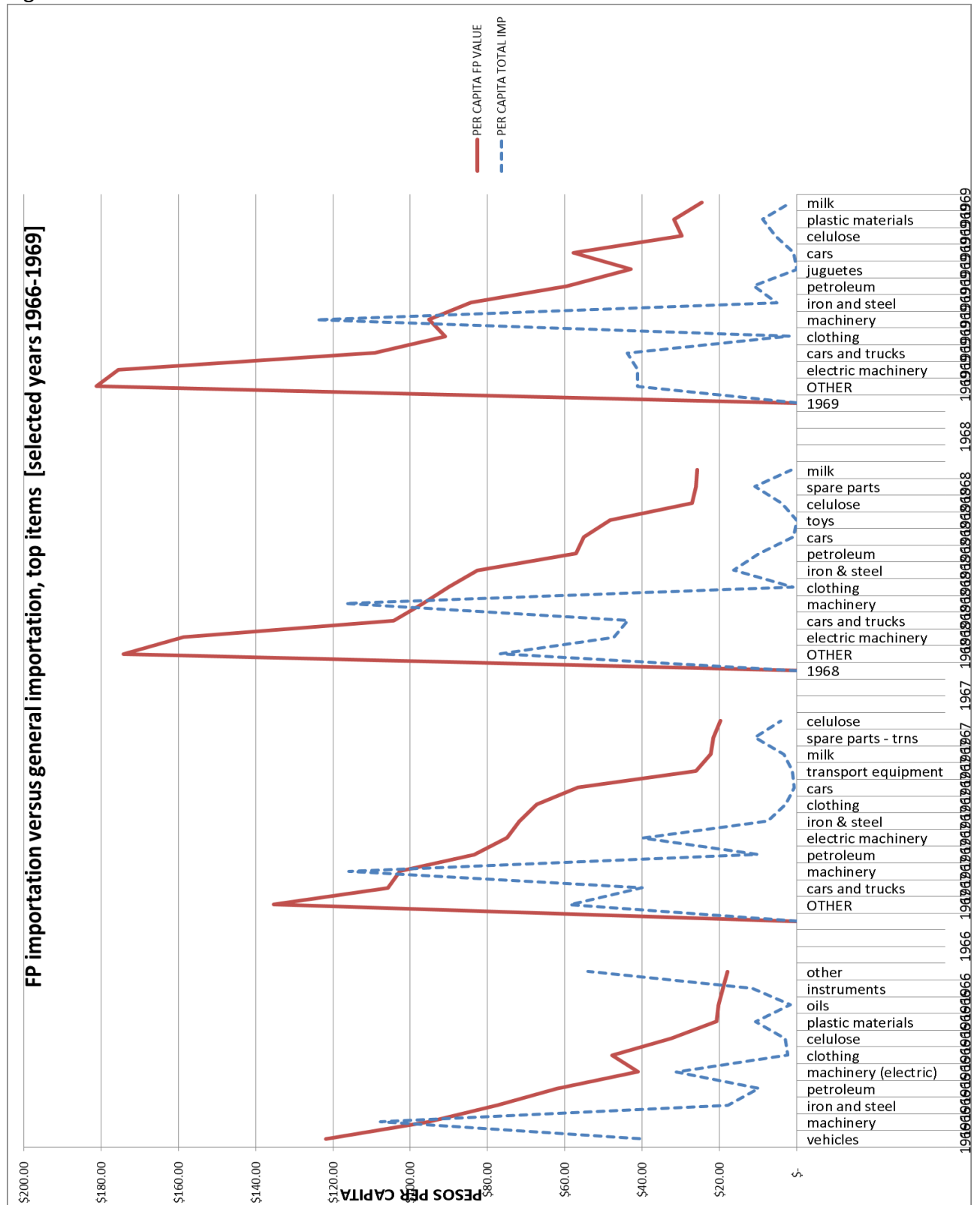
Source: author's own calculations using AEEUM statistics

Figure 11



Source: author's own calculations using AEEUM statistics

Figure 12



Source: author's own calculations using AEEUM statistics

5.5.- CONCLUSIONS

All three quantitative tests carried in this chapter strongly support the claim that the non-tariff trade control device, the licensing system (in tandem with the free perimeters) implemented in 1947 as a temporary strategy to cope with a balance-of-payments crisis, was eventually captured by rent-seeking activities. This is derived from the fact that the system shows *no internal consistency through time*: the staggering lagging behind of reversals is, in itself, a strong piece of evidence. By not meeting its own-set targets for reversing protection –even though such targets would apply to a small fraction of the total of inclusions- the government did in fact grant *gracious benefits* to an important number of firms and industries, and kept doing it for far longer than it should have to.

For their part, the analysis of the free perimeters shows how the perverse incentives under protectionism would work: as trade barriers would be implemented, the increased prices would make it only more profitable to supply such imports by using any means available. In that sense, the licensing system would not only be used to easily get ever-extending protection, it would kept alive a whole underground industry of smuggling, making corruption endemic in the Mexican customs.

5.-FINAL CONCLUSIONS

Qualitative as well as quantitative evidence overwhelmingly supports the general hypothesis that the import licensing system was indeed an important source of rents for a wide spectrum of businesses and, moreover, it remained so for too long a time. The individual cases from Chapter Three show how the licensing would create rents, as well as the diverse nature of them. However, it could be argued that such individual cases do not allow for generalisations; or it could be pointed out that they do not represent the whole of the period and that, in any case, rents and rent-seeking to some extent would be unavoidable if the country was to industrialise. That is why Chapter Four takes the opposite approach and identifies the overall trends. By revising, year by year, the decrees –over 6,000- concerning the inclusion of items under the requisite of a license, it is staggeringly clear that such trade control policy was not even internally consistent: the reversal of inclusions, as expected from the decrees themselves, was in fact negligible. In turn, the over-extension of protection made smuggling even more attractive –evidence of which is also provided.

Specifically, Chapter Three frames the cases of nine industries by using the distinction between monopoly rents, rising-rivals'-costs rents and "money for nothing" rents accrued from the licensing system. Such categorisation has proven to be effective since it captures a very important distinction: the licensing could create rents at the expense of consumers at large –simply put, an artificial monopoly- but also at the expense of other firms within the same industry and without necessarily raising prices. If all firms are forced to find local supplies for crucial inputs, and one single firm manages to get access to the imported, cheaper inputs, its costs would be significantly lower. If the firm in question always had access to government (meaning it could keep access to imports) it would support and effectively seek the implementation of the licensing as a strategy to raise its rivals' costs.

In the cases of the fruit, poultry, gloves, linoleum, tin and automobiles/ancillary industries, the licensing was indeed implemented as a way to grant de-facto monopolies. Even though it is not possible, from the materials found in the archives,

to draw precise figures for the increases in profitability, it is nonetheless clear that stakes were high indeed. The tin industry –three large firms- saw the price of the pound of tin to increase from US\$1.03 to US\$3.16. This is a substantial difference, even if, admittedly, costs for Mexican firms were somewhat higher than for American ones. The government itself reckoned, as early as 1954, that this was indeed a problem. President Ruiz Cortines –seen as both legitimately concerned about inflation and as an honest politician- issued a decree on the issue, stating clearly that “In practice, it has been the case that some firms have used protection only to obtain disproportionate profits at the expense of consumers and against the interests of the society at large”. Tellingly, no other President would be as concerned about this as Ruiz Cortines, and the extent that protection reached in a few years’ time –especially during the seventies- dwarfs that of his own *sexenio*.

Regarding rising-rivals’ costs rents, the case of the Soap industry is the most telling; as part of the import-substitution process, local suppliers of lard managed to get protection, thus imposing higher costs for all soap-making firms. However, the one owned by a former army officer gets a permit to import 5,000 tons of lard at once. The internal documents clearly show the extent to which the SIC was aware of the sensitive nature of the permit, thereby keeping it secret. It was, by all means, cronyism.

Firms exporting produce to the US market also faced higher costs by being forced to buy vehicles produced domestically; the evidence clearly shows that such firms would constantly try to obtain permits to import cheaper vehicles and trucks, and the SIC would repeatedly reject them. Coincidentally enough, an application that was not only granted but processed in the record time of one day, had the business card of a senator attached to it.

The Submersible pumps’ case shows one of the limits of, or challenges stemming from, trade policy: that of technology. It is clear that Mr. Notholt –an entrepreneur seeking to import water-proof motors for submersible pumps- was right: a new-born Mexican firm producing dozens of different models and under-investing in R&D would not be able to compete with an old, German, highly specialised firm. He would insist to the SIC that quality was simply not matched, and that, the firm would need to invest far more in research. The SIC, as expected, supported the Mexican supplier.

At best, officials were overly-optimistic (which was the overall attitude given the sheer size of the growing industrial sector) and no evidence could be found of the motor-maker having close ties with the SIC.

In all, these are neat examples of the priority given to the domestic producer at the expense of consumers or other firms, while the latter one also shows the complexity and difficulty of substituting high technology-content products.

Lastly, Chapter Three also presents some evidence for rent extraction or “money for nothing” rents; these are conceptually different since they do not accrue to private business but public officials and bureaucrats whose position allows to profit from trade restrictions in general. An informal excise upon merchandise arriving at or crossing the border epitomises it: the trader is not getting something in exchange for the bribe; he is simply spared the damage of costly delays. The evidence sent by businessmen to the SIC shows the extent to which it was an established practice in the Acapulco customs, and shows that collected bribes were in fact far higher than the salaries customs officials would have received.

Chapter four presents a quantitative approach to the licensing system; as such it brings new data to life by analysing the patterns of inclusions of products into the category of “licensed” (that is, banned from importation). This implied the construction of a database with more than 6,000 individual decrees naming particular products, from 1947 to 1980. The results overwhelmingly support the thesis of the licensing as a rent-creating device. First of all, while there were 3,754 inclusions and 409 deferrals, there were only 393 reversals during the whole period. Even after 1967, when the inclusions would start having a clear time limit, the observed reversals were literally negligible: they would reach their peak in 1972, at 114, only to flatten at 0 in 1974, whereas the expected reversals by year was over 1,000 by 1974. Machinery and equipment, plus chemical products, are by far the biggest categories. This, along other statistics, establishes beyond any doubt that the licensing system had *no internal consistency through time*: the staggering lagging behind of reversals is, in itself, a strong piece of evidence. By not meeting its own-set targets for reversing protection –even though such targets would apply to a *small fraction* of the total of inclusions- the government did in fact grant *gracious benefits* to an important number of firms.

The quantitative approach also deals with smuggling, which can be thought of as the natural consequence of over-protection, and it does so in two ways: first, accounting for the difference in the trade statistics –the gap between the value of US imports to Mexico as reported by Mexico and the value of US exports to Mexico as reported to the US. Secondly, it quantifies the importation to the free perimeters in the border areas that would be diverted –smuggled- to the cities away from the border.

Strikingly, for all the years analysed (1947-1976) the gap in such numbers is actually positive: every single year, imports to Mexico were underreported. As a percentage of total exports, it peaked in 1948 at 8.92%, and then remained below 1% for most of the years, only to rise slightly in the seventies. Crucially, such missing value would in turn generate substantial bribes to officials and profits for the smugglers.

Finally, the analysis of the importation to the free perimeters firmly proves that it was way above the expected level of consumption. In fact, imports to free perimeters grew at a compounded rate of 13.30% each year, twice as much as the general importation; the expenditure per capita in such area, while stable below US\$200 until 1968, ballooned to US\$800 in 1974. Moreover, using per-capita comparisons, it is clear that the difference is not only big but very consistent across different types of products. In short, it not possible to argue that such level of consumption was in fact taking place in the free perimeters.

Both the rents accrued to producers –either at the expense of consumers or other firms- and the rents accrued to officials or bureaucrats had long term implications; first and foremost, some manufacturing firms relied on a captive market for too long, negatively impacting productivity growth; second, by maintaining a licensing system whose defining features were opacity and arbitrariness it would only invite more corruption, and send the wrong message about it. Also, the sheer size of smuggling would make corruption endemic in the Mexican economy –at least at its borders- and would divert resources, both economic and human, to the easy money that “*fayuca*” would provide.

In sum, the licensing system epitomises the political economy of Crony Capitalism: economic entitlements are created and distributed; some actors have the resources to obtain and, moreover, to secure them, which in turn only reinforces the system. Thus, Cronyism is bad for growth because it only widens the gap between the private

and the social returns of some economic activities; an opaque, discretionary and arbitrary import licensing system did exactly that by creating monopolies and blocking competition at the stroke of a pen.

Perhaps no economy is completely free from rent-seeking activities, but even after the trade reforms of the nineties, it is clear that Mexico does still suffer from widespread cronyism. The ways and the extent to which losses are socialised after a crisis –the 1994 rescue of the banking system being a case in point-, the sometimes murky privatisations and the startling resilience of monopolies in key industries to this day attest that cronyism and rent-seeking remain competitive.

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