

## Why Regions Fail: The Mexican Case

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In my book with Daron Acemoglu, *Why Nations Fail*, we argue that rich countries are rich because they have inclusive economic and political institutions, while poor countries are poor because they have extractive economic and political institutions. What does this mean?

By institutions I mean the rules that govern and shape economic and political life. Let me give some examples. An example of an economic institution would be the rules of an *ejido* that governed how individuals could gain access to plots of land and whether or not this land could be rented out or sold. A political institution would be the *dedazo* that was the way until recently that Mexican Presidents nominated their successors. These institutions can be written down in the law, like the rules of an *ejido*, but they can also be informal like the *dedazo*. An extreme example of an informal institution would be “obedezco pero no cumplo” (I obey but I do not comply) which was an informal rule that formal rules would not be obeyed!

Institutions can be inclusive or extractive. Inclusive economic institutions create the incentives and opportunities necessary to harness the energy, creativity and entrepreneurship in society. Extractive economic institutions do not. For instance, the rules that governed access to land in *ejidos* were extractive because they meant that farmers did not have security of property rights. This reduced their incentives to invest in the land and also to adopt better technology that could have boosted productivity. The fact that they could not sell the land also gave them less incentive to give up farming and move to a job that they were better

suited for. Poor countries on average have extractive economic institutions while rich ones have inclusive ones. As opposed to extractive economic institutions, inclusive ones give people incentives and opportunities. For example, in the 19<sup>th</sup> century the United States became the world's most innovative economy. At the heart of this was the patent system that gave anyone the opportunity to take out a patent to protect intellectual property rights. These rights could be defended in the legal system and created the incentives to innovate.

Why could one country have extractive economic institutions and another not? Countries do not acquire extractive institutions by chance, but they choose them through a political process. For example, the origins of the form economic institutions took in the *ejido* was a complex consequence of the power of the post-Revolutionary state to expropriate existing landowners, the demands of campesinos for land reform and the strategy the PRI adopted for consolidating the Mexican state, and its control over it, in the 1920s and 1930s. It was a political choice. If the *ejido* featured many extractive economic institutions it was because Mexican political institutions at this time were extractive. Those with power shaped the *ejidal* institutions in their interests.

Extractive political institutions are made up of two important dimensions. First, they allocate political power narrowly. Second, they feature a central state that is not strong in the sense that it can provide key public goods. Countries differ in these dimensions. The state built in Mexico after the Revolution was stronger than some in Latin America, for example Colombia, but it was weak in many dimensions and political power was narrowly exercised by the PRI. The extractive economic institutions in the *ejido* come from both aspects of political institutions. They were partly designed to control rural people, that was an element

of the post-Revolutionary state building project, but possibly also a substitute for a strong central state, and at the same time this control helped to solidify the political dominance of the PRI.

In *Why Nations Fail* the focus was on using these concepts to explain the economic success and failure of nations. But the concepts equally apply to differences between regions within a country. Above I said that on average poor countries have extractive institutions, but within a country some parts may be much more extractive than others. For example while Mexico has an income per-capita which is about 20% of the US level, the income per-capita of Chiapas, Guerrero and Oaxaca (let me call them the South) is only 40% of the Mexican average, making it a mere 8% of the US level. Inequality also differs a lot within a country. The standard measure of income inequality, the Gini coefficient, ranges from zero (complete equality) to one (inequality). It is about 0.55 in Mexico and 0.45 in the US. Yet the Gini coefficient in both Chiapas and Oaxaca is over 0.8 suggesting much higher levels of inequality. Our theory implies that these differences within Mexico can be explained by the fact that the South have more extractive economic and political institutions than the rest of the country and that they had special conditions that interacted with the national level extractive institutions in particularly unfortunate ways.

Let me begin with some observations about institutions in Mexico in general and then turn to the South. The poor economic record and very high levels of inequality in Mexico are representative of the Latin American development path. This poverty and inequality ultimately stems from the way colonial society formed in Latin America, based on the exploitation of indigenous people to the advantage of a small Spanish and creole elite. In

other words based on extractive institutions. These institutions outlasted Spanish colonialism and attempts at Liberal reform in the 19<sup>th</sup> century and took on new but related forms during the *Porfiriato*. After the Revolution the status quo was not generally possible in Mexico amidst such mass political mobilization and demands for social change, yet new types of extractive institutions emerged as the post Revolutionary state consolidated. At a political level these focused on the creation of the political parties that subsequently became the PRI, the pacification of the countryside through the redistribution of land and creation of *ejidos*, and the development of a particular political pact between the PRI, organized labor and big business. Political institutions were extractive in the sense that the PRI controlled a one party state that lacked political inclusiveness and the post-Revolutionary state was also weak in many aspects. An example of this weakness is the fiscal system. As part of the pact with business the PRI did not tax profits and capital. As a result as late as the 1970s tax revenues were only around 10% of national income which provided insufficient resources to build a modern state.

I hope you are not reacting to this argument by rejecting it as a tirade against the old PRI. This is not at all the case. Mexico was in an unenviable position in the late 1920s after almost two decades of violence and political instability preceded by 30 years of extractive authoritarian growth. There was no easy way out. To me the political economy model forged by Plutarco Calles and Lázaro Cárdenas has provided the basis today for a transition to a functioning inclusive society. To see what I mean let me compare it to Colombia. Colombia had multiple versions of the Mexican Revolution; the War of a Thousand Days between 1899 and 1902, *La Violencia* between 1948 and the early 1960s, the war between the guerilla and the paramilitaries in the late 1990s and early 2000s. But Colombian political elites never

managed to create such a durable institution like the PRI. Their versions of power sharing, such as the *Frente Nacional*, always fell apart and they were never able to effectively promote agrarian reform or establish the authority of the state in rural areas. While the Mexican state may have taken only 10% of national income in taxes in 1970, this number was 6% in Colombia. Even the reaction of the state to drug violence is significant. The Colombian state reacted to the power of Pablo Escobar in the 1990s not by making itself stronger, but by privatizing the war against him via such paramilitary groups as Los Pepes. In Mexico today the state is attempting to rise to the task of controlling the drug gangs. In Bogotá today it is fashionable to talk about the 'Colombianization' of Mexico. In fact what Colombia needs is the Mexicanization of Colombia!

How does the South fit into this? At the time of the Revolution the South was already the poorest part of Mexico and probably the most unequal. Significantly, it played only a marginal role in the Revolution itself. The peasants of Oaxaca did not rebel in the way those of Morelos did and revolt in Chiapas came late and was quickly controlled. Thus the elites who had controlled the states during the Porfiriato, for example the so called familia chiapaneco in Chiapas, continued to control power after the Revolution. This had some important consequences. Since the South had not rebelled during the Revolution, there was much less need to pacify it so that it benefitted less from agrarian reform. This is particularly true of Oaxaca. In Chiapas the *ejido* is far more important but the previous elites maintained their lands in a way that seems to have been quite unique in Mexico. If you accept the argument that the *ejido* was inefficient economically and used as a method of political control, this looks like a good thing. Yet in fact I would conjecture this is one of the reasons for the extremely high levels of inequality in Chiapas and Oaxaca. Though Revolution

followed by *ejido* was not ideal, in the long run it was better than no Revolution. For the same reasons, the relatively politically un-mobilized South was almost completely left out of the political coalition that the PRI put together to run the country. The South did not have large amounts of urban formal sector labor or big business and the traditional elites had many instruments and long experience in exercising social control. This implied that national public policies under the PRI, which focused on creating benefits for their political coalition were aimed elsewhere in Mexico, for example towards the North. The South was starved of public funds and crucial infrastructure, for example irrigation works or roads. This makes a lot of sense politically: the PRI delegated more political control to local elites that reduced the incentive for it to allocate resources for public goods there. This did not mean that the PRI did not do well politically in this region. Quite the contrary, it was only in 2010 that the PRI lost control of the governorship in Oaxaca. It took a coalition of the PAN and PRD and a former PRI Senator candidate to achieve this upset, as it had in Chiapas in 2000. The relationships formed between the PRI and local elites produced a very durable political base. The *dedazo* was still be used to decide who the next governor was in Oaxaca as recently as 2006.

Thus a simple way to think about the poverty and inequality of the South is to see it as a hang over of the institutions that have generally shaped the inequality and poverty of Latin America. It is possible to unpack this a little into two dimensions: exploitation and neglect by the state. The historic exploitation of indigenous peoples through institutions such as the *encomienda* and *repartimiento* created a very hierarchical unequal society based on extractive economic institutions. These extractive economic institutions were kept in place by extractive political institutions. The worst of all combinations come, as they do in Chiapas

and Oaxaca, when this exploitation is coupled with the neglect of a weak state. Of course the details of the institutions have changed a lot since 1519 and even since 1910. We know today that the South has less efficient legal systems that are less good at enforcing laws and Southern states have governments that are more clientelistic and corrupt in the way they interact with citizens. The real work of describing and conceptualizing the structure of these institutions in the South remains to be done.

What to do about this? The theory says that to solve these problems political institutions have to become less extractive. Once this happens, inclusive economic institutions will followed and poverty and inequality will fall. Mexico has made enormous progress in some dimensions in moving towards inclusive political institutions and both the national and state level. It has democratized and the political coalition that favored the North has disintegrated and lost power. The distribution of political power has become broader. Modern national programs like *progesa*/*opotunidades* do not discriminate against the South. In the last years has seen important attempts to strengthen the state, for instance in attempt to eliminate organized crime as I mentioned. Yet there is much to be done, in particular in terms of making the local state work better and it remains to be seen if the broadening of the distribution of political power and the emergence of political competition will create the right institutions to build a fully modern state in Mexico. To understand whether this will happen we need to understand better how local political institutions, often informal, impede the creation of inclusive institutions and how elites have maintained the extractive institutions of the South. Many issues are important. For example, an important puzzle here is how the state interacts with indigenous groups and their political institutions in the South. Since the introduction of the *ley de usos y costumbres* 418 municipalities in Oaxaca have decided

to use traditional political institutions to elect their mayors. The impulse of indigenous communities to withdraw from a weak Mexican state is a natural reaction but are the institutions set up under this law inclusive? Do they help or hinder the strengthening of the state? Are the political incentives there that can help strengthen the local state?