"IT'S NOT PERSONAL . . . IT'S STRICTLY BUSINESS"[1]

The Operation of Economic Enterprise in Mexico during the Nineteenth and Twentieth Centuries

Mark Wasserman

Rutgers, The State University of New Jersey

THE MEXICAN ECONOMY, 1870–1930: ESSAYS ON THE ECONOMIC HISTORY OF INSTITUTIONS, REVOLUTION, AND GROWTH. Edited by Jeffrey L. Bortz and Stephen Haber. (Stanford, CA: Stanford University Press, 2002. Pp. 348. $60.00 cloth, $24.95 paper.)

THE POLITICS OF PROPERTY RIGHTS: POLITICAL INSTABILITY, CREDIBLE COMMITMENTS, AND ECONOMIC GROWTH IN MEXICO, 1867–1929. By Stephen Haber, Armando Razo, and Noel Maurer. (New York: Cambridge University Press, 2003. Pp. 382. $75.00 cloth.)

THE POWER AND THE MONEY: THE MEXICAN FINANCIAL SYSTEM, 1876–1932. By Noel Maurer. (Stanford,CA: Stanford University Press, 2000. Pp. 250. $60.00 cloth.)

E. Alexander Powell in 1910 summed up the feelings of many foreigners who conducted business in Mexico during the regime of Porfirio Díaz:

> All the great financial deals in which the government is interested pass through their [*científicos*] hands and are molded by them. . . . Among them [científicos] numbered the presidents of the leading banks of the republic and the foremost corporation lawyers; between them they control the national finances and the avenues of trade. . . ."[2]

This tight-knit inner circle that greatly influenced the dictator comprised José Yves Limantour (the group's leader), Ramón Corral, Enrique C. Creel, Guillermo Landa y Escandón, Joaquín Casasús, Fernando

1. "Michael Corleone: It's not personal, Sonny . . . It's strictly business." *The Godfather.* Motion picture based on the novel by Mario Puzo, produced by Albert S. Ruddy (Hollywood, CA: Paramount Pictures Corp., 1989).

2. E. Alexander Powell, "The Betrayal of a Nation," *The American Magazine* 70 (Oct. 1910): 717–18.

Latin American Research Review, Vol. 40, No. 3, October 2005
© 2005 by the University of Texas Press, P.O. Box 7819, Austin, TX 78713-7819

https://doi.org/10.1353/lar.2005.0070 Published online by Cambridge University Press

Pimentel y Fagoaga, Pablo Macedo, Rosendo Piñeda, and Hugo Scherer. Powell pointed particular venom at the Compañía Bancaria de Obras y Bienes Raíces, the Bancaria, which he called "a very convenient cloak for the grafters."[3] Until recently, the general historiography has not only concurred with this assessment, but it has extended the interpretation to the revolutionary and post-revolutionary period (1910–1940).[4]

The three studies under review go a long way towards correcting the historical stereotype of Mexican enterprise as corrupt and inefficient, operating through personal relations rather than through the functions of bureaucracy and marketplace. Together they mark a breakthrough by applying social science theory and methods to history. They provide an enormous amount of data on many sectors of the Mexican economy during both the era of Porfirio Díaz and the Revolution. This essay, however, will focus on the four authors' explorations of the political economy of the period, especially their concepts of "credible commitment" and "vertical political integration" (VPI).

CREDIBLE COMMITMENTS

Stephen Haber, Noel Maurer, and Armando Razo in their provocative *The Politics of Property Rights* set out to explain that political instability did not cause economic stagnation in Mexico. Both theoretical and common sense understandings of political economy (the two not being necessarily the same) would imply that political instability would adversely affect economic growth. The empirical data, however, do not support this hypothesis. Haber, Razo, and Maurer discover that a paradox lies in the so-called "commitment problem":

> any government strong enough to define and arbitrate property rights is also strong enough to abrogate them for its own benefit. Unless the government can give the population strong reason to believe that it will not act in its own short-run interest (by seizing property or taxing away all of the income it produces), the population will not invest. (Haber et al., 2)

As such, no investment results in limited economic activity and insufficient tax revenues for the government. The government, it follows, must limit its actions in order to assure its own long-term survival. The solution to this dilemma, according to Haber, Razo, and Maurer, lies in the fact that investors care above all for the sanctity of *their* property rights. They do not require that government protect property rights as a public good. Based on this, the Porfirian government was able to set up

3. Ibid., 719

4. Stephen H. Haber, *Industrialization and Underdevelopment: The Industrialization of Mexico, 1890–1940* (Stanford: Stanford University Press, 1987).

https://doi.org/10.1353/lar.2005.0070 Published online by Cambridge University Press

mechanisms for credible commitments to selected asset holders. "These mechanisms neither require the rule of law nor a stable polity. What they require is credible threats of retaliation by investors" (Haber et al., 10). These threats could come from either a foreign power of possible intervention or a powerful political group aligned with investors. Vertical political integration, the blurring of the lines between asset holders and the government, enables the credible commitment to function.

Haber, Razo, and Maurer use the cases of Mexico during the Díaz (1877–1911) era and the Revolution (1911–1929) to provide empirical evidence for their hypotheses. Operating in an unstable polity with weak formal political institutions, Mexican leaders strove to increase their wealth and survive politically. Díaz brought "order and progress" despite lacking an administrative structure to collect taxes, having limited possibilities of obtaining foreign loans due to past defaults, and having scarce domestic resources available to finance his government. He established political stability and economic growth by "abandoning the goal of protecting property rights globally. Instead, he specified and protected the property rights of a select group of asset holders and used the rents generated from this selective protection to subdue or seduce his political opponents" (Haber et al., 44). In order to obtain the funds to co-opt his opponents, Díaz encouraged investment. This in turn demanded that Díaz enforce property rights "as private, not public, goods. It also required Díaz to make a credible commitment to select asset holders . . ." (Haber et al., 47). Díaz in effect created monopolies for his privileged supporters. He also provided asset holders with the means to monitor the government and enforce their privileges. Consequently, the dictator integrated economic elites directly into the governing process and involved regional bosses in businesses dependent on government actions. "He turned potential political enemies into third-party enforcers of the property rights system he was creating with Mexico's asset holders" (Haber et al., 48). Díaz's vertical political integration proved quite successful.

With the eruption of revolution in 1910 and the subsequent destructive civil war that ensued until 1920, Mexico once again returned to a condition of regional fragmentation that had existed before 1880. The new revolutionary government with General Alvaro Obregón (1920–1924) at its head confronted a new set of regional bosses in its attempts to reestablish order and renew economic development. Obregón and his presidential successor, Plutarco Elías Calles (1924–1928), constructed what the authors describe as a "curious coalition of revolutionary generals turned landlords, Porfirian bankers and industrialists, and gangster-led unions" (Haber et al., 76) to replace the old Díaz system of vertical political integration.

The VPI that emerged after 1940 replaced regional bosses with labor unions. The revolutionary government did not, like Díaz, bring

https://doi.org/10.1353/lar.2005.0070 Published online by Cambridge University Press

business people into politics, but rather pushed government into business. But the system maintained its base on the selective enforcement of property rights for a privileged sector. The mechanisms were similar to those of the Díaz regime, as well. One national bank, the Banco de México, obtained a monopoly on the issuance of currency, and provided capital for powerful politicians (Obregón and Calles, for example), and loans to the government. The Banco de México acted as "a punishment coordination mechanism" [author: need page numbers]to keep the government from acting as a predator.

The concept of the "commitment problem" is a rather ingenious analysis of the Díaz regime. Haber, Razo, and Maurer first construct the theory based on other social science approaches and then apply the Mexican case quite persuasively. In some ways, however, they present a variant on an older theme of the triangular relationship between national, state (or regional), and international interests.[5]

BANKING

Certainly, Maurer, Haber, and Razo would agree with Powell that banking was the linchpin of Mexican economic development under Díaz and during the Revolution. But they present substantially different analyses and conclusions. Maurer, in *The Power and the Money,* argues that underpinning Mexico's political economy during the era of Porfirio Díaz (1876–1911) and the Revolution (1911–1940) was the need for both the government and private enterprise to raise capital. Because the Porfirian regime was administratively incapable of financing its needs through taxes, it created the near monopoly in banking held by the Banco de México (Banamex) and the Banco de Londres y México (BLM) in order to prevent a recurrence of the crisis of 1883–1885, which resulted from the government's reckless borrowing. Initially, the Mexican government created a private bank, Banamex, granting it almost complete control over federal finances along with a series of profitable privileges, including a monopoly over the issuance of bank notes. In return the bank was to "cross-subsidize" lending to the federal government. Banamex fulfilled two government goals. It expanded the amount of funds available to the government, extending the latter a large line of credit, and it acted as a central bank or lender of last resort that would enable the government to confront emergencies. The Díaz government needed a bank to finance its needs because it was unable to access

5. Peter Evans, *Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil* (Princeton: Princeton University Press, 1979). See also Mark Wasserman, "Foreign Investment in Mexico, 1876–1911: A Case Study of the Role of Regional Elites." *The Americas* 36 (July 1979): 2–21.

https://doi.org/10.1353/lar.2005.0070 Published online by Cambridge University Press

European capital markets as a consequence of past Mexican loan defaults and the contemporary scarcity of domestic resources. The creation of Banamex enabled the federal government to gain access to the credit required to establish and maintain political order and to subsidize the construction of the desperately needed railroad network that was to prove the pillar of Mexico's economic development. Haber, Razo, and Maurer analyze these arrangements in terms of a workable solution to the commitment problem. The Díaz government allowed the major financiers to write and enforce their business rules. The government in return obtained an open line of credit from the largest bank.

Maurer finds that "property rights in Porfirian Mexico were inherently politicized" (Maurer, 46). Because there were no institutional protections to limit the government, the only way to avoid unfair treatment was to pay off powerful politicians. "By binding the interests of the state governors to the interests of the banks, Porfirian Mexico managed to create a credible commitment that the bankers' property rights would not be violated . . ." (Maurer, 46).

Insecure property rights, however, had widespread repercussions in banking. They precluded firms that could not offer collateral for loans. The lack of enforced disclosure laws exacerbated this problem, for investors could not acquire even reasonably trustworthy information about an individual enterprise. Companies associated with banks, however, could establish a good reputation, using the bank to raise capital. Investors sank their monies into the banks, rather than individual businesses. Entrepreneurial groups associated with the banks (which they had organized) thus were able to enhance their reputations among investors, in part by emphasizing the shared trust that allowed them to join together to protect investors from individual firms' defaults and to collectivize risk. And in fact Maurer finds that companies associated with banks were less likely to fail or change hands.

The government's financial policies present us with an insight into exactly how the Díaz regime functioned. It was a delicate balancing act, indeed. First, Banamex lost its monopoly, because the rival BLM had important political connections. Consequently, the BLM also obtained the right to issue bank notes and other privileges. Then, the Commercial Code of 1884, which banned all banks without federal charters from issuing notes and severely limited the ability of existing banks to issue additional notes, encountered resistance from powerful state governors, the most important of whom was Luis Terrazas in Chihuahua. Eventually the parties worked out an agreement allowing Terrazas (and others) to remain in the banking business. Thereafter federal banking policies not only had to satisfy the government's need for access to credit but had to distribute benefits to state governors. According to Maurer, this gave the governors a stake in the nation's political stability. As

https://doi.org/10.1353/lar.2005.0070 Published online by Cambridge University Press

delineated by the General Banking Act of 1897, governors received the right to distribute a single banking charter in each state, which inevitably went to the governors' political allies. This new set of arrangements provided the government with a group to act as third party enforcer in the scheme of vertical political integration, the state governors and national politicians with stakes in banking.

Thus business and politics were inseparable. So, it appears, were familial and friendship connections. Maurer finds that kinship groups in Mexico "established banks in order to draw long-term and impersonal capital into their entrepreneurial activities" (Maurer, 93). While we already surmised this from previous studies, Maurer interprets this phenomenon as less criminal conspiracy than sensible business practice.[6] The biggest problem the banks confronted was acquiring sufficient information to evaluate the credit-worthiness of potential borrowers. They solved this dilemma by lending other peoples' money to themselves. Banks made long-term loans to individuals and firms associated with their directors. Maurer sees this as a "rational solution to the information asymmetries inherent in the banking business congruent with the social customs and legal institutions" of the day (Maurer, 94). He goes on to insist that insider lending was not fraud. Stockholders knew that they were really buying shares in the business interests of the bank's board of directors when they purchased stock in the banks. Interlocking boards of directors, furthermore, were not collusion but monitoring mechanisms. Maurer concludes that the banking system was remarkably stable despite insider lending, pointing to the fact that only two banks failed with losses to depositors during the Porfirian era.

The Banco Central Mexicano, founded in 1898 as the Banco Mexicano Refaccionario, and the Caja de Préstamos para Obras de Irrigación y Fomento de Agricultura, founded in 1908, were two additional examples of the operation of the Porfirian system as it applied to banking. The Banco Central functioned as a "clearinghouse, guarantor of state bank notes, and crisis-insurance scheme" (Maurer, 62). It involved all the elements of the regime's economic mosaic, including powerful regional political bosses and business leaders, national financial leaders, influential power brokers, and foreign investors. But it could never quite gain acceptance among the regional banks or the general public. In the crisis of 1907, it failed to provide state banks with the support they required.

The federal government then turned to the Caja de Préstamos, which it used to bail out the banks. Although it was created to lend small farmers funds to improve their lands, the Caja actually expended its capital

6. Mark Wasserman, *Capitalists, Caciques, and Revolution: Native Elite and Foreign Enterprise in Chihuahua, Mexico, 1876–1911* (Chapel Hill: University of North Carolina Press, 1983).

https://doi.org/10.1353/lar.2005.0070 Published online by Cambridge University Press

buying up the other banks' bad loans. This practice allowed the regional banks to remove the problem loans from their books and at the same time receive a massive infusion of funds. Limantour, the finance minister, used the Caja to inject capital into the banking system in the wake of the economic crisis of 1908. In doing so, he bailed out the state banks that were salvageable. The Díaz regime had to placate the political bosses and their *camarillas* in the states, using the Caja to this end.

The Porfirian banking system nearly collapsed during the civil war that began in 1913. Mexican governments from Venustiano Carranza (1917–1920) through President Plutarco Elías Calles (1924–1928) understood that they had to restore the financial system not only to resume economic growth but for them to survive politically. As one government followed another, all suffered hyperinflation, fleeting economic policies, expropriations, violated contracts, and other depredations. The relations between the various warring factions and the banks boiled down to the fact that the revolutionaries and counterrevolutionaries desperately needed funds that the banks possessed. The Constitutionalists, led by Carranza, were the ultimate victors in the long civil war. They destroyed Mexican banking by shutting down two-thirds of the banks and printing large quantities of worthless currency. The Constitutionalist government literally stole the specie reserves of a number of important banks. The Revolution erased the Porfirian banking system, leaving its successors to rebuild. Alvaro Obregón and Calles rebuilt banking through vertical political integration. The new Banco de México became the mechanism for commitment. The losers in the arrangement were foreign creditors. "[I]t is surprising that circa 1921, after eight years of forced loans and legalized theft, there was any banking system, left at all" (Haber et al., 108). But the banks recovered and soon began to grow rapidly. A number of Porfirian bankers reappeared.

Since the new government sought exactly the same goals as had Díaz—reestablishment of peace and order and the acquisition of capital for economic development—it set out to reconstruct the Díaz system. The bankers wrote the rules and the government created the Banco de México (Banxico) both to tie together bankers and politicians and to insure the government would keep its promises. The only difference was that Calles focused on restoring domestic finance, while allowing the foreign debt to de facto default. As a result, Mexican banking grew rapidly during the 1920s (Maurer 161). Insider lending again prevailed. Calles and his brother-in-law received large loans from Banxico, as did other important politicians.

INDUSTRY

The Díaz era transformed manufacturing from a sector with small, family-run firms that used labor-intensive methods and produced for

https://doi.org/10.1353/lar.2005.0070 Published online by Cambridge University Press

local markets into a sector of large-scale, capital-intensive enterprises. Like banking, manufacturing evolved as monopolies and near-monopolies. Government protected nascent, privileged industries through tariffs. Manufacturing companies operated similarly to the banks in that they had interlocking boards of directors filled with Porfirian insiders. The revolution adversely affected industry because it shut down the transportation network and exacted funds through extortion. Once the fighting had for the most part ended, the new Constitution of 1917, especially Article 27, which declared that private property was a privilege and not a right, presented even more of a threat.[7] The labor provisions of the constitution severely limited property rights. Haber, Razo, and Maurer maintain that organized labor through the Confederación Regional de Obreros Mexicanos (CROM) acted as the third party enforcer of the system of vertical political integration in manufacturing under Obregón and Calles. Everyone benefited from the arrangement. Manufacturers received tariff protection and in some instances subsidized raw materials. The government obtained the support of the CROM in fraudulent elections and against armed rebels. The unions got substantial wage increases and job security.

According to Sandra Kuntz Ficker and Edward Beatty in their chapters in Bortz and Haber, the Díaz government fostered industrialization because "for the first time tariff protection was framed within a wider developmentalist commercial policy" (Bortz and Haber, 162). The government selectively protected some industries. Kuntz Ficker argues that until the 1890s Mexico's foreign trade fell victim to high tariffs, prohibitions, and unnecessarily costly regulations. Thereafter the government lowered duties and eased regulations. Beatty agrees that the Díaz government used tariff policy to encourage investment in domestic manufacturing. Without protection domestic industry could not have stood up against the tide of foreign goods.

AGRICULTURE

Agriculture did not fit the pattern the authors describe for banking and industry (they also discuss mining and petroleum). Before the Revolution the federal government was involved in the "specification" of property rights, but did not enforce the property rights system. There was no vertical political integration, but rather a coalition between large

7. Article 123 of the Constitution of 1917 brought about an eight-hour day, six-day week, equal pay for equal work, profit sharing, minimum wages, the right to organize and strike, protection for workers from arbitrary firing, mandatory labor arbitration, and other reforms.

https://doi.org/10.1353/lar.2005.0070 Published online by Cambridge University Press

landowners and local political bosses. When the revolution eliminated local políticos, property rights were for a time up for grabs. Haber, Razo, and Maurer discovered that the Revolution did not have an adverse long-term impact on agriculture. Large landowners constructed their own VPI consisting of the landowners, the government, and revolutionary generals, the latter acting as enforcers in exchange for rents. It was not until the Cárdenas era that there were widespread land redistributions. The third party enforcers, the generals, had been badly weakened and could no longer protect the VPI.

LABOR

The Mexican Revolution transformed labor-management relations, profoundly affected notions of private property, and restructured the system of vertical political integration in the factories. During the Díaz regime organized labor existed on the margins. By the end of the 1920s Mexico had the most extensive set of laws and regulations and the most extensive government apparatus concerning labor in the western hemisphere. As a result, argues Jeffrey Bortz (in Bortz and Haber), private property rights substantially changed. Labor unions (in this case comprising textile workers) challenged management's right to run the factories. During the 1910s new laws and practice effectively took factory discipline away from the owners, but the unions were not strong enough to actually take over. As a result the revolutionary state assumed the middle ground, and a system emerged in which workers, owners, and state shared power in the workplace. This situation reflected the overall political economy of the 1920s, when no institution or group had sufficient power to dominate. Contestation and negotiation ruled the day. His assertions neatly complement Haber, Razo, and Maurer's analysis of the post-revolutionary vertical political alliance.

THE COST

Haber, Razo, and Maurer concede that the Porfirian credible commitment through vertical political integration was economically inefficient. "Díaz's solution created an extraordinarily concentrated and inefficient financial system, which resulted in a serious misallocation of resources" (Haber et al., 90). The system was wasteful and unfair. Some non-competitive industries survived artificially. Industry concentrated when competition would have been better. Those without political influence had few, if any, opportunities. The whole system functioned only when the government earned sufficient rents to pay off its participants. As a consequence, it was likely to degenerate into crony capitalism (Haber et al., 35).

https://doi.org/10.1353/lar.2005.0070 Published online by Cambridge University Press

Maurer argues that the Porfirian regime imposed "real costs" on Mexico's economic development. "A truly federal system under the rule of law would have encouraged regulatory competition among the states. States with relatively liberal banking policies would have grown faster and attracted more investment than those that allowed small groups of political insiders to monopolize the provision of capital" (35). He maintains that while not the optimum solution, the Porfirian system was what was feasible at the time, and it was better than chaos.

The limits on entry into banking made for substantial profits for Banamex and BLM, because they earned monopoly rents. "Half the assets of the banking system were tied up in protected and inefficient institutions" (Maurer, 70). Acting as classic monopolists, the two banks restricted loans and credits. Banamex absorbed as much of the resources available to the banking system as possible in order to control the supply of credit.

Maurer calculates that this strategy cost the Mexican economy 1.6 percent of Gross Domestic Product during every year of the Porfiriato. Maurer calls this a "substantial amount" (Maurer, 91). Actually, it is staggering. Maurer also maintains "there was nothing pernicious about insider lending in and of itself. What was pernicious was that few individuals or groups could participate in it, because of legal restrictions that limited entry and offered the existing banks limited protection from competition with each other, in a context of weak property rights. The problem was not too much insider lending—"it was not enough insider lending" (Maurer, 95). To Maurer the personal nature of bank lending "was a reasonable response to information asymmetry, and not a sign of personalistic business culture" (Maurer, 103). Maurer also concludes that the "individual strategies" (111) of Porfirian banks did not hinder Mexican industrialization. The banks supplied badly needed capital to a wide array of mining, industrial, and agricultural enterprises, using both foreign and domestic funds and even investing their own profits as well. The system's major flaw was in the stultifying effect insider banking had on entrepreneurship, particularly among rising middle groups prior to 1907, which was one of the reasons members of this frustrated class joined the Revolution.

The concentrated banking structure contributed to Mexico's "remarkably concentrated industrial structure," in combination with restrictive regulation, insider lending, and poor property rights. He surmises that "the fastest-growing firms were not the best firms: they were the best-connected firms" (Maurer, 115).

CONCLUSIONS

This short essay hardly does justice to the vast amount of data and provocative analyses in the three books on areas other than commitment

https://doi.org/10.1353/lar.2005.0070 Published online by Cambridge University Press

and vertical political integration. The Bortz and Haber collection, for example, contains excellent essays on financial markets, long-term credit, foreign trade, and commercial policy. Haber, Razo, and Maurer include prolonged explorations of the impact of the Mexican Revolution not only on banking, but manufacturing, oil, mining, and agriculture.

Despite enormous quantities of data in all three studies, there are at times, particularly in the Haber, Razo, and Maurer volume, problems with the evidentiary base. They often claim that individuals or groups were motivated by or realized one or another factor, but they provide no documentation for their assertions.[8] Maurer in *The Power and the Money* has mined the archives of the Banco Nacional, which provides documentation for some assertions. Both Maurer and Haber, Razo, and Maurer might have benefited from research in the papers of José Y. Limantour, Diaz's finance minister, and the Colección del General Porfirio Díaz.

Nonetheless, the three volumes constitute an impressive contribution to the business and economic history of Mexico during a most crucial period of its development.

8. See page 108: "Calles...realized this, and sacrificed foreign credibility in favor of domestic credibility"; page 248: ". . . the government had every incentive to abrogate those concessions or raise taxes—and the mining companies knew it"; page 252: "A more plausible. . . ."; page 262: The Mexican government could not, however, actually enforce any of these *de jure* changes in property rights and the miners knew it." In each case there are assumptions and assertions made, but no letter or memorandum is quoted.

https://doi.org/10.1353/lar.2005.0070 Published online by Cambridge University Press