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Integrity risks for international businesses in Mexico

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Over the past decade, Mexico has managed to transform its economy, decrease its oil dependency and develop its manufacturing capacity. Between 2012 and 2018, the Mexican government undertook a number of reforms that have helped to foster competition in a number of sectors, notably in the oil and telecommunications industries.

Despite this, enforcement of the relatively strong legal and institutional anti-corruption framework remains poor. Corruption is perceived by citizens and businesses alike as one of the main challenges in the country, and its effects have further aggravated the crisis in the judicial system, the failings of the police force and the wave of violence linked to organised crime.

Query

Please provide an overview of the most pressing integrity risks affecting international businesses operating in Mexico.

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Global evidence of the impact of corruption on business and investment

A sizeable and growing body of evidence has provided clear indication that, at the aggregate level, corruption is bad for business.¹ While cross-country panel data have shown that corruption adversely affects economic growth and market demand, firm-level studies have established corruption's detrimental effect on firm growth, innovation, productivity and return on investment.

¹ Corruption has been shown to have a detrimental effect on:

- growth (Aidt 2009; Anoruo and Braha 2005; Glaeser and Saks 2006; Knack and Keefer 1995; Méndez and Sepúlveda 2006; Méon and Sekkat 2005; Rock and Bonnett 2004; Ugur and Dasgupta 2011)
- international trade (Ali and Mdhilat 2015; De Jong and Udo 2006; Dutt and Traca 2010; Horsewood and Voicu 2012; Musila and Sigue

Main points

- Mexico is considered one of the most open economies in the world and has free trade agreements with some of the most important economic powers, including the US, the EU and Japan.
- Between 2012 and 2016, president Enrique Peña Nieto, in collaboration with the opposition, passed a number of structural reforms, including the new national anti-corruption system (SNA).
- Both petty and grand corruption are widespread in the country and an obstacle to conducting business and are a result of the weak rule of law that prevails in the country.
- Violence and organised crime remain an issue and regularly disrupt businesses in certain areas of the country.

- 2010; Thede and Gustafson 2012; Zelekha and Sharabi 2012)
- market openness (Hakkala et al. 2008)
- return on investment (Lambsdorff 2003)
- foreign investment inflows (Javorcik and Wei 2009; Thede and Gustafson 2012; Mathur and Singh 2013; Zurawicki and Habib 2010)
- business competitiveness and productivity (Fisman and Svenson 2007; Hall and Jones 1999)

Corruption in a given country or market is harmful in two mutually reinforcing ways: in highly corrupt settings, aggregate firm growth and performance is lower, while markets perform poorly when corporate corruption becomes commonplace compared to markets in which firms typically refrain from corrupt behaviour.

Effect on markets

High levels of background corruption have adverse effects on a country's economic performance by reducing institutional quality, undermining competitiveness and entrepreneurship, distorting the allocation of credit and acting as a barrier to trade (Ali and Mdhillat 2015; De Jong and Udo 2006; Horsewood and Voicu 2012; Musila and Sigue 2010; Rodrik, Subramanian and Trebbi 2004; Zelekha and Sharabi 2012).

Corruption has a long-term deleterious impact on the regulatory environment and the efficiency of the state apparatus as it creates incentives for politicians and public officials to create more regulations, restrictions and administrative procedures to have more opportunities to extort payments from citizens and companies. This, in turn, is likely to exacerbate rent-seeking behaviour and breed inefficiencies across the public sector (Argandoña 2004; Dzhumashev 2010).

Unsurprisingly, studies show strong associations between corruption, protectionist regimes and opaque bureaucratic systems (Bjørnskov 2009; Bandyopadhyay and Roy 2007). This is particularly problematic for the business environment, as corruption subverts the fair awarding of contracts, reduces the impartiality and reliability of public

² Transition economies as taken to refer to countries in Central and Eastern Europe, as well as the Commonwealth of Independent States (Asiedu and Freeman 2009; Batra, Kaufmann and Stone 2003).

³ 51% of business people felt corruption makes an economy less attractive to foreign investors, 90% felt it increases

services and skews public expenditure (Transparency International 2011).

Corruption also acts as a non-tariff barrier to trade, raising transaction costs and obstructing foreign investment (Zurawicki and Habib 2010; Ali and Mdhillat 2015; Dutt and Traca 2010; De Jong and Udo 2006; Thede and Gustafson 2012; Mathur and Singh 2013). It is no surprise, therefore, that corruption is positively and significantly correlated with lower gross domestic product (GDP) per capita, less foreign investment and slower growth (Ades and Di Tella 1999; Anoruo and Braha 2005; Kaufmann et al. 1999; Knack and Keefer 1995; Hall and Jones 1999; Javorcik and Wei 2009; Méndez and Sepúlveda 2006; Méon and Sekkat 2005; Rock and Bonnett 2004). In fact, some studies have found that in transition economies,² corruption is the single most important determinant of investment growth, ahead of firm size, ownership, trade orientation, industry, GDP growth, inflation and the host country's openness to trade (Asiedu and Freeman 2009; Batra, Kaufmann and Stone 2003).

Effect on firms

Corruption imposes a clear burden on companies, and surveys show that business leaders almost unanimously agree that corruption undermines a level playing field to the benefit of less competitive firms (KPMG 2011).³

On average, enterprises operating in countries with high levels of background corruption have relatively lower firm performance than those operating in markets with lower risks of corruption (Donadelli and Persha 2014; Doh et al. 2003;

stock market volatility and discourages long-term investment, and 99% agree corruption undermines the level playing field to the benefit of corrupt competitors.

Faruq and Webb 2013; Gray et al., 2004; Mauro 1995; Wieneke and Gries 2011). Recent empirical research has, for instance, found a significant negative correlation between background levels of corruption in US states and the value of firms located in those states (Dass, Nanda and Xiao 2014).⁴

Firm-level data on informal payments from the 2010 World Bank Business Environment and Enterprise Performance Survey found that, in some countries, bribery imposed an additional tax on businesses, representing as much as 10% of their sales (OECD 2016). Worldwide, 14% of firms expect to have to pay a bribe to get an import licence, a figure that rises to 27% in South Asia and 30% in East Asia (World Bank 2018). Corruption in foreign trade can therefore act as a severe deterrent to market entry. This is especially the case for UK firms; a 2015 survey found that 43% of UK compliance and legal professionals indicated they had decided against doing business in a particular country due to high corruption risks (Control Risks 2015).

Even where foreign companies are able to gain a foothold in a corrupt market, studies have shown that greater levels of corruption are associated with higher firm exit rates, suggesting that corrupt environments are highly unstable for businesses (Hallward-Driemeier 2009). Revealingly, 55% of 1,400 CEOs questioned in a recent PwC (2016) survey identified bribery and corruption as a threat to their business's growth prospects.

Nonetheless, when operating in highly corrupt markets, foreign firms unfamiliar with local practices may be inclined to engage in corruption, or succumb to public officials' efforts to solicit

bribes in the name of short-term profit maximisation. Doing so is likely to be counterproductive, as corruption commonly affects business growth and productivity, lowering performance, innovation and long-term growth prospects (Fisman and Svenson 2007; Starosta de Waldemar 2012; Rossi and Dal Bo 2006).

Moreover, corruption begets corruption; firms with a propensity to pay bribes not only find themselves spending more time and money dealing with the bureaucracy but also suffering from the indirect costs, such as lower productivity and more expensive access to capital (Nichols 2012: 334; Wrage 2007; Almond and Syfert 1997; Earle and Cava 2009; Krever 2008). Finally, a lax corporate culture can inculcate unethical and unsustainable business practices or lead to internal fraud. If detected, the costs and sanctions, as well as reputational impact, can be extremely costly for companies.

UK exports and overseas investment

Both the nature of the UK's top exports (mechanical appliances, precious metals, motor vehicles, mineral fuels and electronic equipment [HMRC 2018a: 6]) and the kinds of export markets in which UK firms operate entail corruption risks. A number of the UK's top trading partners include countries like Russia, India, China, Vietnam and Saudi Arabia (HMRC 2018b), in which UK companies can be exposed to elevated risks of coercive or collusive corruption (Transparency International 2014).

Alongside the trade in goods, the UK has rising stock of foreign direct investment (FDI) in markets and industries with high associated risks of corruption. Between 2005 and 2014 alone, UK

⁴ Dass et al. assessed Tobin's Q as an indicator of firm value against local corruption using a proxy of corruption-related convictions of public officials between 1900 and 2011.

Tobin's Q provides a means of estimating firm value by dividing the total market value of the firm by the total asset value of the firm.

outward FDI to African countries doubled from £20.8 billion to £42.5 billion (ONS 2016). Over half of this investment in Africa was in mining and quarrying (ONS 2016), a sector judged to be the most corrupt in an OECD (2014) study, which found the extractives industry accounted for 19% of all foreign bribery cases.

Encouragingly, a 2015 survey (Control Risks 2015) found that business leaders in economies such as Nigeria, Mexico, Brazil, India and Indonesia largely welcome measures to level the playing field and address the inconsistent enforcement of domestic anti-corruption laws.

Why tackle corruption?

Corruption stacks the deck against competitive, innovative and entrepreneurial companies seeking to expand their overseas operations. This is increasingly recognised by business leaders: a survey of 390 senior executives revealed that 70% believed a better understanding of corruption would make them more competitive, help them make smarter investment decisions and enter new markets (PwC 2008).

Transparency is fundamental to reduce information asymmetries in complex markets; it underpins the ability of companies to fully understand the conditions and constraints for entering and operating in a given market (OECD 2016). Anti-corruption initiatives that reduce the necessity of “insider knowledge” of bribery patterns, middlemen and intermediaries have the potential to lower business costs, reduce uncertainties and reputational risks, lessen vulnerability to extortion and make access to capital easier (Transparency International 2009). Targeted efforts to curb corruption have been

shown to yield significant benefits to improve the regulation of the business environment (Breen and Gillander 2012).

As well as helping to make the business environment more conducive to inward investment and market entry by foreign firms, measures to reduce corruption in key markets have the potential to stimulate greater market demand by unleashing greater economic growth and increasing disposable income (Aidt 2009). A 2010 study found that more effective control of corruption in sub-Saharan Africa had the potential to dramatically increase trade volume in general and imports in particular (Musila and Sique 2010).⁵

Ultimately, efforts to reduce corruption in high risk markets have the potential to edge out competitors from countries with higher incidences of corruption. As Belgibayeva and Plekhanov (2016) show, there exists kind of a virtuous cycle between investment flows and control of corruption:

- there are greater investment flows between countries with good control of corruption
- as corruption decreases, investment from countries with lower incidences of corruption increases
- as the quality of a country's institutions and control of corruption improves, the country may even attract less investment from countries with widespread corruption
- greater investment volumes from less corrupt countries can further reinforce the strengthening of economic and political institutions that keep corruption in check

⁵ The authors estimate that if a country with the same corruption perception index as the African average of 2.8 were to improve its corruption level to Botswana's 5.9, its

exports would improve by about 15% and imports by about 27%.

The Mexican economy and international investment

The enduring characteristic of the Mexican state from 1929 to 2000 was the existence of a hegemonic political party, the Institutional Revolutionary Party (Partido Revolucionario Institucional, PRI) that controlled most social organisations. The PRI regime emerged from the Mexican Revolution (1910 to 1917) and, based on the constitution of 1917, it used the symbolic power of the revolution as the source of the regime's legitimacy and as a justification for its wide-ranging intervention in the Mexican economy.

Steadily increasing discontent with the single-party PRI government fuelled a surge in support for the opposition parties in 2000: the right-wing National Action Party (Partido Acción Nacional, PAN) and the left-wing Party of the Democratic Revolution (Partido de la Revolución Democrática, PRD). The PAN candidate, Vicente Fox, won the 2000 presidential elections essentially on an anti-PRI vote. His victory raised high expectations of change, but Fox failed to construct more democratic institutions and continued to apply the orthodox liberal economic model. His government's social assistance policies did not manage to significantly reduce poverty and inequality.

This set the stage for polarisation between those who had benefitted from the Mexico's economic model and those who had suffered because of it. In the highly polarised 2006 elections, the PAN candidate, Felipe Calderón, won by a minute margin (0.56%) after a campaign marred by the intervention of President Fox and the business sector. PRD candidate Andrés Manuel López Obrador denounced the elections as fraudulent, declared himself the legitimate president and launched a movement of resistance against the incoming government. This political crisis influenced President Calderón's decision to send

the army onto the streets to fight the drug cartels. In part a political tactic to gain legitimacy by showing López Obrador's opposition that the president had the support of the army, it was also seen as a genuine strategy to fight the growing power of the drug cartels. Since that time, the war against the drug cartels has become Mexico's main challenge, with violence escalating to unprecedented levels.

With the 2012 election of Enrique Peña Nieto, the PRI returned to power after 12 years in opposition. Under president Enrique Peña Nieto's leadership, Mexico put together "the most ambitious reform package of any OECD country in recent times" (OECD 2017b: 1). These reforms were made possible thanks to the political consensus achieved by the unprecedented *Pacto por México*, a political agreement signed by the three main political parties in December 2012 that contained commitments to fuel economic growth, reduce the levels of violence in the country, address corruption and strengthen the justice system, among others (Pacto Por México 2012). Some of the reforms approved between 2012 and 2018 included those in the education, labour, tax, health, telecommunication, energy and justice sectors. A new national anti-corruption system (*sistema nacional anticorrupción*, SNA) was also created through a constitutional reform in 2015 with the goal to better prevent, investigate and sanction corruption (Secretaría de la Función Pública 2018). The government's reform agenda, as well as some of its early political and economic successes, however, were paralysed and overshadowed by violence and human rights-related scandals, such as the Tlatlaya and Ayotzinapa massacres.

Main features of the Mexican economy

Mexico is now the world's eleventh largest economy (in terms of GDP measured at purchasing

power parity), and the economy has evolved from an oil-dependent one up to the early 1990s into a strong manufacturing and trade hub, thanks, partly, to the North American Free Trade Agreement (NAFTA) (OECD 2017a). The proximity to the US market has also given the country a competitive advantage, and 80% of Mexican exports are destined for the US (Villarreal 2017).

Mexico is recognised as one of the most open economies in the world. The country has signed 12 free trade agreements (FTAs) with a total of 46 countries, more than any other country in the world, including the US, Canada, the European Union, Japan, Israel and 10 countries in Latin America. Additionally, the country is party to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (TPP), which, once ratified by the signatories, will link 11 Asia-Pacific economies. Mexico's commitment to trade integration and liberalisation is also reflected in the increasing importance of trade for the national economy. Between 1994 and 2017, the proportion of trade as a percentage of GDP increased from 28% to 78%, according to World Bank statistics (World Bank Open Data 2018).

Over the past two decades, Mexico has benefitted from credible economic management that has allowed the country to weather a period of low oil prices and significant currency volatility (US Department of State 2018). GDP growth, at 2.0% and 2.3% in 2017 and 2018 respectively (per the International Monetary Fund), is relatively strong compared to Mexico's G20 peers. When compared to other emerging markets, however, Mexican growth over the past decade has been weak. Additionally, inflation rose in 2017 to reach 6.6% due to the depreciation of the Mexican currency and a jump in retail fuel prices caused by government efforts to stimulate competition in that sector. The Bank of Mexico has undertaken

orthodox policy measures to tackle inflation, which many analysts expect to return within the 2% to 4% target range by the end of 2018 (US Department of State 2018).

Until the mid-2000s, oil-related activities accounted for about 13% of GDP. Over the last decade, however, declining oil extraction from Pemex, the national oil company, had an important effect on the oil-GDP contribution, which fell to about 8% in 2016 (OECD 2017a). Moreover, prior to the 2013/2014 constitutional reforms, Pemex had a monopoly on all hydrocarbon activity in the country. The reforms have opened this sector, allowing domestic and international private firms to bid on hydrocarbon projects and partner with Pemex, creating significant new investment opportunities for Mexican and foreign investors in upstream, midstream and downstream business lines (US Department of State 2018). While the reform has yet to reverse the fall in oil production, as of July 2018, more than 70 private firms from a number of countries had committed to investing at least US\$180 billion in oil exploration projects (Johnson 2018).

Oil-related revenues and exports were also a major source of government revenues and foreign exchange receipts, but they also declined significantly in recent years due to the collapse of oil prices and the increase in tax revenues following the tax reform. This oil dependence caused several difficulties when global energy prices collapsed, but the reforms implemented in 2014 to improve Pemex's governance, gradually open the oil sector to private and foreign participation, and to decrease the budget reliance on oil revenues have therefore been timely (OECD 2017a).

The tax reform introduced by the government in 2014 has raised non-oil tax revenue collection in 2015 and 2016 by about 3 percentage points of

GDP and compensated for the fall in oil-related revenues over the period. Overall public spending grew in 2016 due to the government's financial support of Pemex, growing debt service payments and pension costs. With total revenue rising faster than expenditure, the public sector borrowing requirement (PSBR) has declined by 1.1 percentage points of GDP to 3% of GDP in 2016, and is expected to reach 2.9% in 2017 and 2.5% by 2018. The 2017 budget set the path to the return to primary surplus. Additional spending cuts of about 1.0% of GDP compared to 2016 were approved. Those cuts will fall mostly on current expenditures in communications, transportation, tourism education and agriculture.

In telecommunications, reforms intended to improve competition and reduce concentration in the sector included the creation of a new, autonomous regulator. This regulator is empowered to order divestitures, enforce regulations and apply targeted sanctions to companies it sees as overly dominant in the market. The increased competition in the telecommunication sector led to a decline in the prices of phone and internet services of up to 75%, which helps explain why mobile broadband subscriptions more than tripled between 2012 and 2016 (OECD 2017b).

While it is still too early to determine the overall impact of the reforms, some have started to show positive results: the labour, tax and social security reforms have helped reduce informality, with more than 3 million formal jobs created since 2012. In the healthcare sector, out-of-pocket spending has fallen, and the introduction of a sugar tax has helped slow the growth of obesity. The most significant changes in Mexico's investment outlook have taken place in the energy and telecommunications sectors (US Department of State 2018).

Foreign direct investment

Historically, the United States has been one of the largest sources of FDI in Mexico. According to Mexico's Secretariat of Economy, FDI flows to Mexico from the United States totalled US\$13.8 billion in 2017, nearly 47% of all inflows to Mexico (US\$29.7 billion). The automotive, aerospace, telecommunications, financial services and electronics sectors typically receive large amounts of FDI. Most foreign investment flows to northern states near the US border, where most maquiladoras (export-oriented manufacturing and assembly plants) are located, or to Mexico City and the nearby "El Bajío" (e.g. Guanajuato, Queretaro, etc.) region.

Historically, foreign investors have overlooked Mexico's southern states, although that may change if newly created special economic zones gain traction with investors (US Department of State 2018). At just 2.6% of GDP, FDI is relatively low compared to that of other countries in the region: they are equivalent to half Brazil's and only a third of Chile's. As a result, the country depends on remittances and a portfolio of investments that are very volatile (Bertelsmann Stiftung 2018).

Main economic challenges

While the ambitious structural reforms and sound macroeconomic policies of the past decade have helped ensure the resilience of the Mexican economy to a number of external challenges, the country still faces a number of issues.

First, the economy has developed in an uneven manner across sectors; productivity has grown in sectors that benefitted from reforms (most notably energy, finance, and telecommunication), but others are lagging behind mainly due to overly stringent local regulations, weak legal institutions, corruption and insufficient financial development

(OECD 2017b). These disparities have also created a two-speed economy characterised by a highly productive modern economy in the north and centre of the country, and a lower productivity traditional economy in the south.

Second, while the country's GDP per capita rose from US\$3,000 in 1990 to almost US\$9,000 in 2017, the benefits of the economic model have not been evenly distributed across the population. According to the OECD, "economic growth has failed to translate into better living conditions for many Mexican families" (OECD 2017a): inequality remains high, as reflected by the Gini index value of 43.4. To put this number into perspective: the richest 10% of the Mexican population hold almost two-thirds of the country's wealth, the top 1% get almost 20% of the national income, and the wealth of the four richest individuals in the country corresponds to almost 9% of GDP (Esquivel 2015). At the same time, almost 44% of the population still live under the national poverty line, according to World Bank statistics.

Finally, economic growth has also been constrained by longstanding social problems, such as the high levels of poverty and informality, low female participation rates in the economy and low educational achievement (OECD 2017a).

Corruption, crime and drug-related violence have also taken a toll on the country's economy. Since the beginning of the so-called war on drugs, the defining policy of Felipe Calderón's tenure as president from 2006 to 2012, the levels of crime and violence in the country have dramatically increased and often make international headlines. The aggressive campaign to capture the leaders of the main drug trafficking organisations in the country led to significant instability among the groups and sparked a wave of violence that continues to date (Beittel 2018).

During President Enrique Peña Nieto's term, which ended in December 2018, the government faced an increasingly complex crime situation that saw violence spike. In 2017, Mexico reached its highest number of total intentional homicides (over 29,000) in a year (The Guardian 2018). Moreover, in the 2017-2018 election period 114 candidates and politicians were killed, allegedly by crime bosses in an effort to intimidate public office holders (Beittel 2018). According to the Global Peace Index, the cost of violence in the country reached US\$249 billion, which is the equivalent to over a fifth of the country's GDP, in 2017 alone (Institute for Economics and Peace 2018).

Towards the end of Felipe Calderón's tenure as president in 2012, Mexico's policy priorities seemed to shift from simply reducing drug-related homicides to recognising that tackling corruption was a necessary pre-condition to successfully countering drug trafficking organisations and the crime and violence they bring with them (Kaiser and Rios 2017). While countering corruption has long been referred to as a government priority, policymakers have often "come up short in passing effective long-term reforms" (OECD 2017b: 22). Anti-corruption efforts have been generally "half-hearted and ineffective" (Casar 2015: 49) and mostly focused on legal reforms and institutional tweaks with little regard to actual enforcement (Casar 2015: 50).

Extent and types of corruption in Mexico

Some of the most widely used measurements of corruption suggest that the phenomenon is widespread in the country and has worsened in recent times.

Mexico's score on Transparency International's Corruption Perceptions Index (CPI), which captures the extent of corruption in the public

sector as perceived by businesspeople and country experts on a scale from 0 (most corrupt) to 100 (least corrupt), dropped from an initial score of 35 in 2014 to 29 points in 2017 (Transparency International 2018). This places the country as one of the most corrupt in Latin America, together with Guatemala, Paraguay, Nicaragua, Haiti and Venezuela.

The World Bank's Control of Corruption indicator (Kaufmann, Kraay and Mastruzzi 2010) paints a similar picture. This index measures "perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as 'capture' of the state by elites and private interests" (World Bank 2018) on a scale from -2.5 (most corrupt) to +2.5 (least corrupt). The latest results show that Mexico's score has significantly declined from -0.41 in 2012 to -0.93 in 2017, which also places the country as one of the most corrupt in the region, only ahead of Haiti and Venezuela.

The perceptions of experts captured by the CPI and the Control of Corruption Indicator are also mirrored in the opinions of the general public. According to the results of Transparency International's Global Corruption Barometer (GCB) for Latin America and the Caribbean, a public opinion survey conducted between May and December 2016 in a total of 20 countries in the region, 61% of respondents in Mexico believed that corruption was on the rise in the country. Moreover, despite the anti-corruption reforms passed by the government in 2015, only 24% of the sample thought that the government was taking effective measures to tackle corruption (Pring 2017).

Based on the country's performance on the indicators mentioned above, it is not surprising that, in the latest edition of the National Survey on Governmental Quality and Impact (Encuesta

Nacional de Calidad e Impacto Gubernamental, ENCIG), a nationally representative survey conducted by the National Statistics Institute (INEGI) on a sample of 46,000 households across the country between November and December 2017, corruption is cited by 56.7% of respondents as one of the main problems in the country. This places corruption as the second-most important concern among the population, only behind security-related issues, which was cited by 73.7% of the survey's respondents (see INEGI 2017).

Administrative/bureaucratic corruption

Petty or bureaucratic corruption refers to the everyday acts of corruption that take place when civil servants meet the public. This form of corruption is often dubbed as "petty" since the sums of money involved tend to be small: for example, paying bribes to get an ID; enrol in a public school; or access the public healthcare system. This form of corruption is "mostly found as bribery linked to the implementation of existing laws, rules and regulations" (U4 Anti-Corruption Glossary) and occurs at the interface between public institutions and citizens to speed up processes and avoid certain procedures or sanctions. Although only modest amounts of money tend to be exchanged, the costs can quickly add up when this type of corruption is endemic.

The GCB also documents the extent of petty bribery in the country. According to the survey, 51% of Mexicans who came in contact with one of six basic public services included in the survey (i.e., public medical care, public schools, official documents, social security benefits, the police or the courts) paid a bribe (Pring 2017). This result placed Mexico as the country with the highest experience of bribery in the region. Although ENCIG 2017 reports a much lower prevalence of bribery in the country (14%), this survey also reveals that almost

half of the respondents (47%) know someone who had to pay a bribe to access a public service (INEGI 2017). It is worth highlighting, however, that there is a big variation in bribery rates across the different services: 60% of citizens who came in contact with the police and 30% of those who required a service from the land registry reported having had to pay a bribe (INEGI 2017). At the same time, bribery seems to be an isolated phenomenon in other services such as passport issuing and tax payments (INEGI 2017).

Grand/political corruption

In contrast to petty corruption, grand or political corruption “is perpetrated at the highest levels of government and usually involves both substantial benefits for the officials involved and significant losses for the state and its citizens” (U4 Anti-Corruption Glossary). It often involves sums of money large enough to distort political processes and influence campaigns or political parties. This type of corruption can refer to specific acts, such as ministers taking bribes to award lucrative government contracts, embezzling public funds or diverting them to benefit certain groups or political supporters. Though large sums of money may be involved, other benefits, like high-level appointments, inside information and policy influence, can be the currency of grand corruption. Widespread political corruption can also lead to private interests significantly influencing a state's decision-making processes to their own advantage. Businesses could, for example, use bribes to influence legislators to pass favourable laws (U4 Anti-Corruption Glossary).

Since grand corruption typically takes place at the public sphere's top tiers and can also involve the highest levels in private businesses, measuring its prevalence is difficult. There is evidence, however, to suggest that this type of corruption is also

widespread in Mexico. According to the World Economic Forum's (WEF) Global Competitiveness Report, deviation of public funds and favouritism in the government's decision-making processes are common (WEF 2017). This assessment is backed by some of the cases of corruption that were brought to light by the media and civil society organisations.

Embezzlement and deviation of public funds

In October 2016, for example, the governor of the Mexican state of Veracruz, Javier Duarte, was forced to resign from his position amid allegations of embezzlement, fraud and deviation of public funds (Villegas 2016). The audits conducted by the federal and local bodies revealed that over US\$3.8 billion dollars had disappeared from the public coffers during Duarte's tenure as governor (Angel 2017). Other governors, such as César Duarte from Chihuahua and Roberto Borge from Quintana Roo, were also accused of embezzlement and illicit enrichment, respectively (Fregoso 2017). In total, 16 state governors, all associated to Enrique Peña Nieto's ruling party, were linked to cases of corruption (Malkin 2017).

Cases of grand corruption in Mexico have not been limited to state or local governments. An investigation by Animal Político, a multi-media outlet, and Mexicans against Corruption and Impunity (Mexicanos Contra la Corrupción y la Impunidad – MCCI), a civil society organisation, revealed a corruption scheme that involved a number of federal ministries, a network of 128 fictitious or irregular companies, and eight public universities. Together, the scheme served to deviate more than US\$430 million dollars' worth of public contracts between 2013 and 2014 (Animal Político 2017). Businesses also believe that “public funds are often diverted to companies and individuals due to corruption and perceive favouritism to be

widespread among procurement officials” (GAN 2018).

Rent-seeking and crony capitalism

In economics, the term “rent” is defined as an “income that is higher than the minimum that an individual or firm would have accepted given alternative opportunities” (Zuniga 2017), such as the income they would have received in a competitive market or the extra income that a civil servant might receive for the transfer of the right to a good or service that is not available on the open market (Khan 2000). Rents might thus come from different sources, such as monopoly profits, import and export quotas, extra income from subsidies or tax breaks, agricultural price supports, occupational licensing, among others. The concept of crony capitalism is closely linked to the notion of rent-seeking. Under this economic system, the success of firms depends more on their ability to secure rents and maintain close relationships with government officials and businesspeople (Mungiu-Pippidi and Martínez B. Kukutschka 2018).

For the past 20 years, crony capitalists have experienced a golden era in a number of countries, including Mexico (The Economist 2016). While crony capitalism can bring investment and economic growth to a country, it also has negative effects on the broader society. Moreover, having to compete for rents or favours from the government can lead to increased risks of corruption (see Boehm 2007; Carpenter and Moss 2014; Dal Bo 2006; Razo 2015 and Wu 2005).

In the case of Mexico, the weak rule of law has led to high levels of impunity towards those who violate market rules and this, in turn allows for monopolistic and rent-seeking practices. This situation has de-facto extended privileges to some market players that allow them to ignore regulations (Ríos 2018: 8). This has occurred

through the use of both legal (e.g. lobbying) and illegal or corrupt rent-seeking practices (e.g. bribery, illegal political contributions, conflict of interest and trading in influence).

The World Economic Forum’s Global Competitiveness Report 2017-2018, shows that businesses believe that public funds are often diverted to companies and individuals due to corruption and that favouritism is widespread among procurement officials (WEF 2017). Additionally, “companies report that they have lost business opportunities due to competitors resorting to corruption and almost half of businesses have failed to win contracts because competitors have bribed procurement officials” (GAN 2018). Some of the recent cases of corruption help exemplify the prevalence of corruption at the highest levels of government, and the close ties between the business and political elites:

- The *Casa Blanca* (White House) investigation: in November 2014, journalist Carmen Aristegui revealed that the First Lady, Angélica Rivera, had purchased a house worth more than US\$7 million dollars in an exclusive Mexico City neighbourhood. The house had been built by Grupo Higa, a construction company that made multi-million-dollar profits thanks to public contracts in the State of Mexico during the tenure of Enrique Peña Nieto as state governor (see Aristegui Noticias 2014). Rivera later returned the mansion, and a government investigation found no wrongdoing by Peña Nieto or his wife. The scandal, however, “contributed to Peña Nieto’s plummeting approval ratings and the sense that corruption was one of the central failings of his government” (Partlow 2016).
- The Odebrecht case: in December 2016, the Brazilian construction company Odebrecht and its petrochemical subsidiary, Braskem, admitted

to having paid bribes amounting to US\$788 million dollars and agreed to a record-breaking fine of at least US\$3.5 billion dollars. The company had paid off politicians, political parties, officials of state-owned enterprises, lawyers, bankers and fixers to secure lucrative contracts in Brazil, Venezuela, Panama, Argentina, Ecuador, Peru and Mexico, among others. Since those revelations, prosecutors across the region have been pressing charges against politicians accused of corruption: almost a third of Brazil's current government ministers are facing investigation, the vice-president of Ecuador was sentenced to six years in jail, and Peru launched investigations against two ex-presidents (BBC News 2017). In Mexico, the former director of Odebrecht Mexico, Luis de Meneses, directly implicated Emilio Lozoya, the former director of Pemex (Christofaro and Verza 2018). The Mexican government, however, has not brought criminal charges against Odebrecht for allegedly paying US\$10 million dollars in bribes to Mexican government officials in exchange for public contracts, and the investigation against Lozoya remains frozen.

Legal and institutional anti-corruption framework

Mexico has ratified the United Nations Convention against Corruption (UNCAC) and is a signatory to the OECD Anti-Bribery Convention and the OAS Convention Against Corruption. Since the early 2000s, the federal government has made efforts to align the country's legal framework to the demands of these international treaties. As a result, the legal framework against corruption in the country is generally considered to be strong (GAN 2018) and is often aligned to international best practices.

However, conflict of interest issues are not well defined in the Mexican legal framework (US

Department of State 2018), and whistleblower protection remains underdeveloped in the country (GAN 2018). Reforms were passed between 2015 and 2016 aimed at re-shaping the anti-corruption infrastructure in the country, but implementation is still underway.

Criminalisation of corruption

The Federal Penal Code, for example, criminalises a number of corruption-related offences, such as active and passive bribery, extortion, abuse of office, money laundering, bribery of foreign public officials and facilitation payments, as per the OECD's recommendations. Similarly, the Federal Public Servants' Responsibilities Law prohibits public officials from requesting or accepting goods or services, either free or at a price less than market value, from individuals or corporations whose professional interests conflict with the official duties of the public servant (GAN 2018).

In addition to criminalising specific corruption offences, Mexico also has specific laws dealing with money laundering (the Anti-Money Laundering Law), which restrict operations in vulnerable activities and provide criminal sanctions and administrative fines for failure to comply (GAN 2018). Public procurement is also regulated through a number of additional laws, including the law on acquisitions, leases and public sector services and the law on public work and related services). These laws address conflicts of interest among federal procurement officials, competitive bidding, asset declaration and monitoring, reviews of procurement decisions and blacklisting measures.

Transparency and access to information

Mexico ranks among the top five OECD countries with regard to the definition and implementation of open government data policies and initiatives.

Mexico's ranking results from "the high-level political commitment shown by the Mexican government to spur the digital transformation of the public sector" (OECD 2018). The country's General Act of Transparency and Access to Public Information, which replaced the previous Law on Transparency and Access to Information in 2016, has been recognised as one of the most progressive in the world. This law was designed to close some of the loopholes from the previous regulatory framework, and it now requires state authorities in all branches, autonomous organisations, trade unions and any other entities dealing with public funds to make all information generated available to the public (OECD 2017b). As a result, the rating of the law, as per the Global Right to Information Index, improved from 120/150 in 2011 to 136/150 in 2018 (Centre for Law and Democracy 2018). This defines Mexico as one of the countries with the best access to information laws in the world, behind only Afghanistan (Centre for Law and Democracy 2018).

In addition to the legal framework, the National Development Plan 2013-18 included open government as main priority. As a result, the government pioneered several open government projects that involved other branches of government, subnational governments and independent state institutions, creating the Open Mexico Network and the Alliance for an Open Mexican Parliament in 2014 (OECD 2018).

The country has also improved access to budgetary information. The Open Budget Index, for example, determined that the Mexican government "provides the public with substantial information" and places Mexico among the top performers in the ranking, behind only New Zealand, South Africa, Sweden, Norway and Georgia (International Budget Partnership 2017).

The national anti-corruption system

In May 2017, the Mexican constitution was amended to enshrine the national anti-corruption system into law and set the stage for the formulation of the necessary secondary legislation for bringing the system to life. In July 2016, these secondary laws were promulgated by President Peña Nieto and included (see OECD 2017c):

- The General Law of the National Anti-Corruption System (*Ley General del Sistema Nacional Anticorrupción*) establishes the institutional and governance arrangements for the new anti-corruption system and outlines its objectives. As a general law, it requires federal states to establish their own systems along similar lines.
- The Organic Law for the Federal Public Administration (*Ley Orgánica de la Administración Pública Federal*) strengthens the Ministry of Public Administration (Secretaría de la Función Pública, SFP) which now is responsible for integrity policies for the federal public administration, including codes of conduct and asset and interest declarations, while retaining its previous mandate over internal control and audit, human resource management, public procurement, transparency and the administrative disciplinary regime. The appointment of the minister, unlike before, is now subject to ratification by the senate.
- The Organic Law of the Federal Tribunal of Administrative Justice (*Ley Orgánica del Tribunal Federal de Justicia Administrativa*) made the Tribunal of Administrative Justice autonomous following a constitutional reform in 2015. This new law establishes the organisation of the tribunal and its courts along with the rules for the selection and removal of magistrates.
- The Organic Law of the Attorney General's Office (*Ley Orgánica de la Procuraduría General de la República*) creates the position of

a specialised anti-corruption prosecutor (*fiscal especializado en material de delitos relacionados con la corrupción*), and outlines the responsibilities of the office.

- The General Law of Administrative Responsibilities (*Ley General de Responsabilidades Administrativas*) replaces the Federal Law of Administrative Responsibilities and lays out the duties and responsibilities of public officials (including the disclosure of private interests). It also sets out administrative disciplinary procedures for misconduct and expands liability for alleged integrity breaches to natural and legal persons.
- The Law of Auditing and Accountability (*Ley de Fiscalización y Rendición de Cuentas de la Federación*) extends the remit of the supreme audit institution (auditoría superior de la federación), allowing for real-time audits and oversight over transfers to subnational governments. The law also makes audit reports to congress timelier to increase accountability for efficiency and results, and better inform budgetary decisions for upcoming fiscal years.

It is worth noting that despite a strong legal framework, “Mexico’s anti-corruption legislation is not effectively enforced” (Bertelsmann Stiftung 2018), and while the anti-corruption reforms were seen as creating “a good foundation to fight corruption” (OECD 2017c), implementation is still a work in progress. The government of Enrique Peña Nieto failed to appoint several key positions, including the anti-corruption attorney, and the federal states have failed to develop the necessary legal reforms to adapt their local anti-corruption systems to the new requirements. As of July 2018, only 15 of the 32 federal states had taken the necessary steps to align their local legislation to the objectives of the national anti-corruption system (Roldán 2018).

Main anti-corruption bodies

The new anti-corruption system is headed by a coordinating committee charged with designing and implementing anti-corruption policies and establishing a framework for coordination between the more than 96 entities at the federal, state and municipal levels charged with countering corruption (Meyer and Hinojosa 2018). The coordinating committee is made up of representatives from the main anti-corruption bodies in the country, which include:

Secretaría de la Función Pública (Ministry of Public Administration)

In 1982, President Miguel de la Madrid created the general comptroller’s office, which in 2003, under Vicente Fox, became the Ministry of Public Administration (Secretaría de la Función Pública, SFP) and has since served as the top-anti-corruption body (Casar 2015). The SFP is the federal entity responsible for “developing and overseeing policies, standards and tools on internal control, including risk management and internal audit functions in the federal administration” (OECD 2017c).

Additionally, the SFP establishes policies and frameworks and provides guidance to line ministries in collaboration with the supreme audit institution. The latest anti-corruption reforms further emphasised its role in preventing corruption through risk assessments. Despite the revamp of the country’s anti-corruption system and the SFP’s newly gained powers, the agency, as a federal ministry, remains under the control of the executive, which means that the president is still in a position to name and remove the head of the agency.

Fiscalía Especializada en Combate a la Corrupción (Special Prosecutor's Office for Combating Corruption)

To reduce political influence over investigations into government malfeasance, the anti-corruption reforms included the creation of an autonomous special prosecutor's office for combatting corruption, headed by an independent prosecutor specialising in investigating and prosecuting corruption cases. The special prosecutor will form part of the new independent national prosecutor's office, which is meant to replace the current attorney general's office but whose implementation has stalled in Mexico's congress. To date, however, the position remains vacant as the senate has failed to appoint the prosecutor (Meyer and Hinojosa 2018).

Tribunal Federal de Justicia Administrativa (Federal Court of Administrative Justice)

The Federal Court of Administrative Justice is part of the national anti-corruption system and is responsible for hearing cases related to serious breaches of the Law of Administrative Responsibilities by public officials and private persons, taken forward by either the Ministry of Public Administration or the supreme audit institution. The court is also responsible for establishing the necessary sanctions and fines. Despite being an autonomous body, the court is not fully independent from the executive, since the president determines the human, financial and material resources that are to be allocated to this body (see *Ley Orgánica del Tribunal Federal de Justicia Administrativa* 2016)

Auditoría Superior de la Federación (supreme audit institution)

The superior audit institution (ASF) is the specialised technical body of the lower chamber of

congress with the authority to oversee the use of federal public resources in the three branches of government, the autonomous bodies, the federal states and municipalities. The ASF also has the power to audit any entity (public or private) that has either collected, managed or spent public resources.

Instituto Nacional de Acceso a la Información (National Institute for Access to Information)

The National Institute for Access to Information (INAI) is an autonomous body responsible for guaranteeing the right of access to public government information, protecting personal data that is in the hands of the federal government and settling disputes over refusals by government agencies to grant public access to information. The INAI's highest governing body is the plenary, which is composed of seven commissioners appointed by the senate.

Citizen Participation Committee

The General Law of the National Anti-Corruption System calls for the creation of the Citizen Participation Committee (CPC). This committee is formed by five civil society representatives and academics "renowned for their expertise and contributions to the field of anti-corruption, transparency and/or accountability in Mexico" (OECD 2017c). The members of the committee are appointed by a specialised selection committee named by the senate, and its goal is to build a bridge between the government and civil society by creating a registry of experts and channelling their research and recommendations into the system. The committee also has its own annual work plan, which may include research, investigations and projects for improving the digital platform or reporting on corruption by the public (OECD 2017c).

Consejo de la Judicatura Federal (Federal Judicial Council)

The Federal Judicial Council is responsible for carrying out investigations and establishing sanctions or disciplinary proceedings for judicial officials. It is thus mandated with enforcing the standards of conduct established in the National Law on Public Security (*Ley General del Sistema Nacional de Seguridad Pública*) among police forces and the code military justice for army officials (OECD 2017c).

Cross-sectoral integrity risks and their impact on firms

Lack of judicial independence

Judicial independence – the extent to which the judicial branch of government is impartial and independent from the executive – is a key element to control corruption as it ensures the objective application of the existing legal constraints and serves as a check on the powers of the other branches of government, which can help control corruption (Mungiu-Pippidi 2015).

In Mexico, however, neither the federal nor the state judiciary are independent from the executive. Based on an executive opinion survey, the World Economic Forum's Global Competitiveness Report, gives Mexico a score of 2.9 out of 7 for judicial independence, which indicates that the judiciary is perceived to be susceptible to influence from the government, individuals or companies (see WEF 2017).

The judicial reform of 1995 created the Federal Judiciary Council, a body that appoints judges and decides on their promotion, and established that the senate elects each supreme court judge out of three presidential nominees. This reform also gave the supreme court the status of a constitutional

court. Since this reform, the supreme court has ruled against the president and congress on several occasions. There have also been occasions, however, where the president has been able to secure a supreme court appointment for a person close to him. In addition, the judiciary has never launched an independent investigation on politicians as, for example, is happening in Brazil.

In addition, the general prosecutor remains totally beholden to the presidency (Bertelsmann Stiftung 2018). At the state level, the judiciary is totally bound to the executive. All the governors that have been accused of fraud and corruption have been able to escape trial. Furthermore, there have been very few cases where corruption by a party, union, congress leader or functionary is brought to justice, despite rampant corruption. More worrisome, the judiciary has partly been bought or infiltrated by criminal groups (GAN 2018).

Impunity and weak rule of law

Mexico's justice system is plagued by delays, unpredictability and corruption, leading to impunity (Freedom House 2017). In contrast to what is happening in Brazil, many of the recent cases of corruption in Mexico involving businessmen and politicians have gone unpunished. Of the numerous cases of corruption by governors, members of congress, judges, lawyers, government officials and corporate executives, only a handful have gone to trial (Bertelsmann Stiftung 2018). Moreover, the punishment for those who are found guilty of corruption have also sparked outrage. Javier Duarte, the governor of Veracruz accused of embezzling over US\$3 billion, for example, was found guilty for criminal association and money laundering, but the punishment for these crimes was a fine worth US\$2,500 dollars and a maximum of nine years in prison (Lastiri 2018).

Other high profile corruption-related cases that remain unsolved include the fire at a kindergarten that cost the lives of 52 infants during Calderón's presidency, the killing of 72 migrants in Tamaulipas, the massacre in Tlatlaya, the problems of metro line 12 in Mexico City, and the many governors that have been proven to have heavily embezzled resources from their governments and remain either uncharged or have fled.

According to the Bertelsmann Foundation, "the increased levels of political democratisation and transparency have contributed to the mass media's autonomy and an increasing number of civic organisations that scrutinise politicians – resulting in increasing numbers of denunciations against corrupt or inefficient politicians – the fact that most go unpunished, merely increases public frustration, demeaning both democracy and the rule of law" (Bertelsmann Stiftung 2018).

Impunity in Mexico, however, is not only applicable to cases of corruption. The 2017 Global Impunity Index (GII) (Le Clercq and Rodríguez Sánchez Lara 2017) places Mexico as the country in the Americas with the highest levels of impunity, ahead of countries like Venezuela, Honduras and Nicaragua. The country holds position 66 out of the 69 countries included in the study, just above India, the Philippines and Cameroon. The GII's findings are further backed by the National Survey on Victimization and Perceptions on Security (ENVIPE) conducted by the National Statistics Office. This survey reveals that only 9.7% of crimes are reported to the authorities and these reports only lead to an investigation in 65% of the cases. This means that no actions are taken against 93.6% of the crimes that occur in the country (see Storr 2018 and INEGI 2018).

The results from the GII attribute the high levels of impunity to the following factors (see Le Clercq and Rodríguez Sánchez Lara 2017):

- **Lack of external accountability:** the current system lacks effective and independent official evaluation procedures, which could ensure quality and truthful information on the security and justice systems, and effect change in institutions and in public policies.
- **Overburden of the courts:** there is a limited number of judges compared with the number of cases taken to courts, which leads to weak penitentiary procedures that lack of adequate attention by judges. According to the GII 2017, there is an average of 16.23 judges per 100,000 inhabitants around the world, but Mexico has only an average of 4.2 judges per 100,000 inhabitants.
- **Lack of resources in the national and local police forces:** the security, justice and penitentiary systems must receive more resources to improve their human capacity, infrastructure and professionalisation.
- **Lack of training:** better training and the professionalisation of the security forces are key to properly enforce the existing procedures. Rather than investing more resources to increase the membership of police forces, Mexico must improve the effectiveness of their actions, particularly in prevention, intelligence and in preparing and integrating information into investigative files.
- **Involvement of the military:** over the past 6 years, the government has strongly relied on the military to improve security across the country. As a result, while police forces lack the necessary training and resources to fulfil their functions, the budget for the Ministry of Defence has increased by 485% to keep more than 270,000 active elements deployed around the country. This is more than double the number of local

police forces that currently exist in the country (120,000).

The quest for rule of law is necessary for fairness and competitiveness. Stability of laws is a pre-condition to reallocate resources from low to high value-added regions, sectors and economic activities. Other sources of stability, such as sound macroeconomics, a functioning democracy and international trade rules, are also important. The economic reason to pursue stability is to have a framework that allows sustainable growth.

As a result of the issues outlined above, businesses in Mexico face a high corruption risk when dealing with the judiciary (GAN 2018). According to the World Economic Forum's Global Competitiveness Report 2015-2016, businesses often perceive that bribes and irregular payments are commonly offered in exchange for favourable judicial decisions (GAN 2018b). Moreover, there is low confidence in the independence of the judiciary and the efficiency of the legal framework in settling disputes and challenging regulations (WEF 2018).

Violence and organised crime

Crimes, such as the killings in Ayotzinapa and Tlatlaya, exposed the widespread corruption and impunity that prevails in many regions and localities of Mexico. They have also laid bare the drug organisations' infiltration of police forces, their control of local judicial systems and economic hold over segments of the population (Bertelsmann Stiftung 2018). This has also highlighted the weakness of the state in some regions such as Michoacán, Guerrero, Veracruz, Tamaulipas and Morelos, where the monopoly on the use of force is contested. The weakness of the state in these regions has made politicians and municipal governments susceptible to pressure and influence from criminal bands. Refusing to cooperate with organised crime in these regions can have fatal

consequences. In 2017 alone, nine mayors were killed, which adds to a tally of more than 50 mayors killed since 2006 (Freedom House 2017). The fact that since mid-2014, communities in some of the regions most affected by violence have organised popular defence groups to fight against the criminal gangs is also due to the lack of response by the government and its inability to assure personal security (Bertelsmann Stiftung 2018).

As a solution to the high levels of corruption in the police forces at the municipal, state and federal levels, and in response to the rising levels of violence, the army has been deployed to help counter organised crime. Instead of helping to curb the problem, however, this has led to allegations of increased corruption in the army (as presumably was the case in Guerrero with the Ayotzinapa massacre) (Bertelsmann Stiftung 2018).

The government's primary security initiative in 2017, the Internal Security Law, passed in December. It was intended to regulate the deployment of the military to fight crime, but was denounced by numerous domestic and international rights observers, including UN and Organization of American States (OAS) officials, as lacking safeguards against potential human rights abuses (Freedom House 2018).

In addition to the crime-related violence, resulting from the activities of criminal gangs that deal in drugs, traffic human beings and extort "protection" money from enterprises, over the past few years "social discontent increasingly erupts into violence" (Bertelsmann Stiftung 2018). Some examples of this include the demonstrations against the murder of the students of Ayotzinapa, especially in the state of Guerrero, but also protests from certain teachers' unions against the educational reform, particularly in Guerrero, Oaxaca and Chiapas.

Additionally, in January 2017, the 20% increase in the price of gasoline led to demonstrations, highway blockages and the looting of stores in many parts of the country, especially in the poorer suburbs of Mexico City and the State of Mexico. This type of violence is “social rather than political” (Bertelsmann Stiftung 2018) and resulted from the lack of social and political channels to express discontent.

The increasing levels of violence in the country have had a profound effect on businesses. In some of the cities most affected by violence, venues are vulnerable to attacks from drug cartels and other organised crime institutions. Trucks and shipments were assaulted on the highways, employees faced security threats, and commercial activities were disrupted or endangered (De la Calle 2018). This also brought an important increase in operating costs derived from security measures. But, as explained by De la Calle (2018), “the greatest threat came from extortion imposed by criminal groups that demanded periodical ‘quotas’ (protection money) from businesses and companies in order for them to be ‘allowed to conduct business’. These quotas are commonly known as *derecho de piso* and they can be collected either by a criminal group, or by the local police in the form of bribery or protection. The result is the same: businessmen are forced to pay for ‘protection’ against possible ‘eventualities’”.

The effects of these practices are particularly strong on small and medium enterprises (SMEs), as they are more vulnerable to extortion. Large companies, including multinationals, often have more means to resist and fight against extortion from criminal gangs (De la Calle 2018). The widespread extortion, not only from criminal groups but also from unions, inspectors (labour conditions, safety standards, health, taxes, environment, police and others) has, in a way, given a competitive

advantage to big companies and multinationals by serving as an entry barrier for SMEs and an incentive for these companies to try to become even bigger to better resist criminal threats (de la Calle 2018).

As the rule of law and competitiveness result in a virtuous cycle, extortion and informality result in a vicious one: since protection has to be paid for, there are scarce incentives for informal SMEs to transition to formality. For them, formality is a state in which they have to

- pay taxes
- contribute to welfare mandates
- be subject to extortion from official inspectors of several kinds

Thus, the key to the transit from informal to formal becomes apparent: reduce extortion in the formal sector (De la Calle 2018).

The complex situation described above carries a high corruption risk for businesses operating in Mexico. Businesses report “very low confidence in the reliability of the police services, and businesses indicate that they face high costs due to crime and violence” (GAN 2018).

Administrative burden/red tape

Excessive administrative burden and too many regulations can open the door for discretion and red tape, thereby increasing the risks of corruption in a country (Mungiu-Pippidi 2015). In the specific case of Mexico, the governments at federal and local levels have made significant efforts to reduce red tape over the past decade. Since 2008, Mexico has managed to reduce the cost and the time that businesses and individuals need to pay taxes, get access to credit and resolve insolvency. As a result of these reforms, the regulatory system is generally transparent and consistent with international

norms (GAN 2018). The World Bank's Ease of Doing Business Index places Mexico as the Latin American country with the least administrative burden (World Bank 2019). Mexico obtained 72 points out of a total of 100 and positioned itself at 54 in the index, close to some EU economies, such as Italy, Hungary and Romania, and ahead of Bulgaria and Croatia.

In August 2015, the government launched the [gob.mx](http://www.gob.mx) platform (www.gob.mx), a portal meant to make bureaucratic procedures faster and more transparent by providing all necessary information for business and citizens in one place. The website provides information on almost 4,000 different services and procedures of the federal public administration. It includes guidelines on what a user needs to do to complete specific procedures, as well as the possibility to download or complete and submit all the required forms online. The portal also allows users to make the necessary appointments for specific procedures and even pay online. According to figures from the Ministry of Public Administration (SFP), the portal has an 85% satisfaction rate and is accessed by 1.5 million users every day (SFP 2017).

Despite the progress seen in recent years, significant administrative barriers still exist, particularly when trying to start a business, register property or get electricity, and the tax system remains highly complex (World Bank 2019). Moreover, corruption hampers the equal enforcement of some regulations (GAN 2018). The World Economic Forum's Global Competitiveness Report, for example, recognises that government regulation represents a significant burden for businesses operating in the country (WEF 2018), and the 2016 National Survey on Regulatory Quality and Governmental Impact on Enterprises (Encuesta Nacional de Calidad Regulatoria e Impacto Gubernamental en Empresas, ENCRIGE,

see INEGI 2016) revealed that enterprises that engage in corruption often do so to speed up procedures (65%), avoid sanctions and fines for failing to comply with regulations (40%), and obtain licences and permits (30%).

The ENCRIGE also reveals relatively little variation behind the motivations to pay bribes across small, medium and large businesses in the country. This means that firms of all sizes often face the same challenges with a similar percentage of firms in each category citing the same reasons to pay bribes. There are, however, differences in the costs of corruption according to the size of the business. While small businesses spend on average 9,084 pesos (US\$475) per year on acts of corruption related to government procedures, access to services and inspections, the cost is five times higher for big businesses, which dedicate, on average, 48,425 pesos (US\$2,500) to corruption-related payments. Medium sized-firms, however, are hit the hardest and direct on average 84,806 pesos (US\$4,450) a year for the same purpose.

Attacks against media and civil society

The media and civil society are often cited in the literature as key actors in the promotion of good governance and control of corruption: a strong civil society and an independent media can act as constraints on corruption by checking the actions of state officials, mobilising citizens to put pressure on the government and disclosing information on corrupt behaviour (see Mungiu-Pippidi 2015 and Kossow and Kukutschka 2017).

According to Freedom House (2018), "legal and constitutional guarantees of free speech have been improving gradually", but violence in the country is a problem for journalists. Reporters probing police issues, drug trafficking and official corruption face an increasingly high risk of physical harm. In 2017, at least 12 journalists were murdered in possible

connection with their work (Bertelsmann Foundation 2018). At least six of these journalists were working on corruption-related stories (Pring, Vrushi and Martínez B. Kukutschka 2018). Most notably, the murders of the widely recognised print reporters, Miroslava Breach and Javier Valdéz, generated particularly wide coverage and uproar (see BBC 2017a). As a result of the violent environment and the inability of the government to effectively protect journalists, self-censorship has increased and many newspapers in areas where violence is widespread avoid publishing stories concerning organised crime (Bertelsmann Stiftung 2018).

In addition to the effects of violence, news coverage in many media outlets is also affected by their dependence on the government for advertising and subsidies (Freedom House 2018). The biggest broadcasting company in the country, Televisa, has faced accusations of supporting specific politicians over the years (usually from the PRI), and in June 2017, reports emerged stating that the government had used sophisticated spyware to electronically spy on perceived opponents (see Estrella 2017). Among the victims of the spyware scandal were anti-corruption activists, journalists and human rights workers critical of the government – including lawyers probing the 2014 disappearance of the 43 Ayotzinapa students. Although the government acknowledged possession of the spyware, it denied specific abuses and resisted making the contracts related to its purchase public. The spyware scandal that broke in 2017 also damaged the civil society organisations’ in the government, especially since several of the victims, particularly the anti-corruption advocates, were also subjected to repeated tax audits (see Ahmed 2017a).

According to the World Economic Forum, attacks on civic freedoms can cost businesses too

(Sriskandarajah 2017). A censored or captured media, for example, makes it costlier and more difficult to gain access to information that might be relevant for risk assessments or business decisions, but that go against the official government narrative, thus favouring companies or businesses with political connections that can gain access to “privileged information”. Similarly, a weak or repressed civil society might be unable to fulfil its role of holding the government accountable. In the case of Mexico, civil society has, for example, played an important role in preventing corruption in the award of public contracts and in ensuring that public procurement procedures are conducted in a fair, lawful and transparent manner through the participatory mechanism known as “*testigo social*” (social witness). This mechanism, which has been embedded in the law, allows citizens and civil society organisations to oversee public procurement procedures for multi-million-dollar projects or purchases (see Rivera, Varela and Gómez 2012).

Business climate in Mexico

As mentioned at the beginning of this paper, Mexico is one of the most open economies in the world and has been characterised by sustained, albeit slow, economic growth, low levels of inflation and high levels of macroeconomic stability. Over the past decade, the country has also managed to transform its economy, decreased its oil dependency and developed its capacity to manufacture high-tech products. The country’s geographic location, competitive production costs and highly-skilled young workforce make the country an attractive destination for international investors. Thanks to its population of over 120 million, the country also offers a large domestic market.

Additionally, between 2012 and 2018, the Mexican government undertook a number of reforms that have helped to foster competition in a number of sectors, such as in the oil industry, which is now open to foreign investment, and the telecommunications sector, which was dominated by a single player since it was privatised in 1990. Additionally, the country ranks ahead of most other Latin American countries and emerging economies in terms of ease of doing business, as measured by the World Bank, and competitiveness according to the World Economic Forum's Global Competitiveness Report 2018.

Despite these positive trends and developments, the country faces significant institutional and governance challenges which have made the effective enforcement of the relatively strong legal and institutional anti-corruption framework de-facto impossible. Corruption is perceived by citizens and businesses alike as one of the main challenges in the country, and its effects have further aggravated the crisis of the judicial system and the wave of violence linked to organised crime.

Nearly two-thirds of Mexicans believe most or all police officers are corrupt (Pring 2017), and security forces often operate with impunity in many regions of the country and have been involved with drug organisations and accused of other law and human rights violations (Bertelsmann Foundation 2018). Attempts to reform the police by dissolving the Federal Police and centralising police forces, however, have not shown results (GAN 2018). As a consequence of the security crisis, businesses often report higher costs to ensure security of their operations, and in some areas they are often victims of extortion by criminal groups.

The judiciary in Mexico is plagued by delays, unpredictability and corruption, which has led to impunity and helped breed even more corruption.

As mentioned before, only 9.7% of crimes are reported to the authorities, and from these, only two-thirds get investigated, which means that almost 94% of the crimes in the country go unpunished. Additionally, the high levels of corruption in the judicial system also mean that justice is served to the highest bidder, i.e. to the side that can afford to pay the highest bribe. The ENCIGE survey conducted by the National Statistics Office (INEGI) reveals, for example, that 11% of businesses paid a bribe to the courts during a trial (see INEGI 2016).

There seem to be close ties between businesses and politics in the country. Some actors in the private sector have employed both legal (e.g. lobbying) and illegal or corrupt rent-seeking practices (e.g. bribery, illegal political contributions, conflict of interest and trading in influence) to obtain privileges that allow them to ignore rules and regulations applied to other actors in the sector, while others have managed to establish de-facto monopolies. Additionally, recent business surveys and corruption scandals reveal that public funds have been diverted to companies with close ties to the government.

Anti-corruption policies in the private sector are a relatively new development in the country. A study by civil society organisations Mexicanos Contra la Corrupción y la Impunidad (MCCI) and Transparencia Mexicana, the local chapter of Transparency International, revealed that out of the 500 biggest companies in the country, 299 (60%) had anti-corruption policies. This is a marked improvement from the last edition of the study conducted in 2016, which showed that only 42% of the sample had such policies in place.

Despite this improvement, the quality of the policies remains low, with an average score of 47/100. The main gaps in these policies exist in

issues related to hospitality and social contributions. There is also an absence of sanctions for violating codes of conduct. It is worth noting that foreign firms were found to have more developed anti-corruption policies than their Mexican counterparts. While the former achieved an average score of 58.4/100, the latter received only 37/100 (see *Transparencia Mexicana 2018*).

Anti-corruption guidance for businesses

Companies looking for guidance on how to manage integrity risks in their operations can draw on ample existing reference material. The following section briefly points to some of the most useful tools and documents for companies implementing anti-corruption measures.

GAN Integrity's Business Anti-Corruption Portal (2018a) provides a good starting point for companies wishing to develop an internal compliance programme. The portal sets out eight elements to a successful compliance programme:

- the development of proportionate written policies and procedures, such as a code of conduct, and the implementation of internal controls
- top-level commitment from the company's senior management to show visible support for a company's compliance activities
- periodic and comprehensive risk assessment to identify the corruption risks affecting a company's operations
- oversight autonomy and resources, namely by investing an individual with responsibility for compliance and establishing a compliance oversight team
- due diligence on third parties, such as joint venture partners, agents, consultants and contractors

- communication and training on policies and procedures
- monitoring and review of the effectiveness of the compliance programme through reports to senior management
- establishing a whistleblowing channel to allow employees to report issues without fear of retaliation

Alternative reference documents providing an overview of the core components of a compliance programme are Transparency International's Business Principles for Countering Bribery (2013a) and the United Nations Global Compact Framework for Action for Businesses Against Corruption (2011).

More detailed guidance on specific anti-corruption mechanisms can be found in other documents. For example, on risk assessment, valuable publications include Transparency International's Diagnosing Bribery Risk (2013b) and the United Nations Global Compact's (2013) Guide for Anti-Corruption Risk Assessment. Free e-learning training courses are available on GAN Integrity's Business Anti-Corruption Portal (2018b) and the Transparency International (2018) website *Doing Business Without Bribery*. The World Economic Forum has also released *Good Practice Guidelines on Conducting Third-Party Due Diligence* (2013).

Many of these publications speak primarily to managing integrity risks in larger multinational companies. There is nonetheless additional guidance available for SMEs on developing compliance procedures proportionate to their operations. The Centre for International Private Enterprise's (2014) *Anti-Corruption Compliance Guidance for Mid-Sized Companies in Emerging Markets* is one such example. The International Chamber of Commerce (2015) has also released a

guide for SMEs on conducting third-party due diligence.

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