The origin of crony capitalism in modern Mexico and its current impact on foreign direct investment

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Abstract

Focusing on Mexico, this paper analyzes to what extent and in which direction domestic crony capitalism (a type of collusive corruption) affects international business activities. First, I introduce the origins and evolution of crony capitalism in Mexico since the Porfiriato (1876-1911); then, I explore how business networks operated in this country at least until the end of Peña Nieto’s period (2012-2018) and how crony capitalism is related to corruption. Finally, by using the case study of Canadian companies investing in Mexico, mainly in the mining sector, since the start of NAFTA in 1994, I explain in which ways these grey areas have an impact on foreign direct investment. My main argument is that crony capitalism does not imply negative consequences for international business activities if other variables are controlled at the domestic level. What is worse, crony capitalism could even generate positive incentives to foreign investors, in a context of weak formal institutions, as is still the case with Mexican institutions, while deepening corruption problems internally by weakening even more the institutional structure of the country. In that sense, this type of corruption do not necessarily elevate the risk perceived by foreign investors if, regardless of the applicable law, they are under the control of the domestic power groups made up of entrepreneurs and government officials, who sometimes negotiate directly with foreign investors. These groups can partially guarantee the success of foreign investments projects and, at the same time, obtain personal benefits. This is one of the main reasons why, even though Mexico has such big corruption problems, many foreign
companies are still willing to invest there: they obtain high earnings and they get guarantees to operate their businesses from local governments at different levels (federal, state, and municipal), something that has also recently been observed in other countries; i.e. Russia.