Opacity in the Management of Public Resources: The Case of Government Trust Funds

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Introduction

The transparency and accountability of financial policy is a major challenge in contemporary Mexico. The most recent data report the existence of 659 government "trust funds, mandates and analogous legal acts," ("*fideicomisos, mandatos y actos legales análogos*") as of March, 2006. These entities handle resources amounting to 17.43 billion USD. This figure amounts to almost two percent of Mexico's Gross Domestic Product. During President Fox's six-year administration alone, the federal government created more than 150 new government funds—most of which, unfortunately, lack appropriate control or oversight.

Recent research has revealed the opacity and corruption of the large-scale 1995 bailout of Mexico's banking system. Using the figure of "banking secrets" ("*secreto bancario*"), the financial authorities held back investigations of the extensive irregularities and have kept the details of the bailout in the dark.[1] Similarly, the authorities have consistently refused to open up government trust funds to public review. The federal government, and the Ministry of Finance and Public Credit (SHCP) in particular, has used the excuse of "trust secrecy" ("*secreto fiduciario*") on innumerable occasions to avoid submitting these funds to the public scrutiny required for governmental accountability.

In principle, trust funds could be instruments which encourage investment and savings. They represent a legal relationship through which a person or an institution transfers resources to another ("trustee") for it to manage and pursue a specific goal or, as the case may be, prepare them for sale or transfer, once the contract's goals are achieved, to a third person ("beneficiary"). As in the case of government trust funds, the person or institution who grants the trust and trustee itself can be the same.

[1] Irma Eréndira Sandoval, *The Politics of Financial "Liberalization": Crisis, Rent Seeking & State Interventionism in Mexico*, Ph.D. Thesis in Politics, University of California, Santa Cruz, 2006; Bernardo González, "Transparencia en el rescate bancario, ¿problemas de agencia, corrupción, imperfecciones de mercado o captura regulatoria?" and Irma Eréndira Sandoval, "Rentismo y opacidad en procesos de privatización y rescates," both in: Irma Eréndira Sandoval (ed.), *Debatiendo las Fronteras entre Estado, Mercado y Sociedad* (Mexico: Laboratorio de Documentación y Análisis de la Corrupción y la Transparencia- Instituto de Investigaciones Sociales/UNAM,). See also: Mario Di Costanzo, *et al.*, *El Saqueo a los Mexicanos* (Mexico: Grijalbo, 2005).

Etymologically, a trust is literally something in which one places their "trust". However, the exercise of public affairs should not function based on trust, but rather on the principle of governmental responsibility. No one should be free from the practice of accountability and the requirement of full disclosure. Trust funds, whether they be public, private or "mixed", should be fully accountable, especially when they handle resources which belong to the taxpayers and affect the fundamental rights of citizens.

Diagnosis

Mexico comes up short in the area of access to information on financial and monetary issues. Recent studies have documented how government agencies, trust funds and public sector companies are not fully committed to the principles of transparency.[2] For instance, although Mexico is a member of the Organization for Economic Cooperation and Development (OECD) and has therefore signed 23 recommendations in the area of "corporate governance", the country has only managed to comply with three: clarifying acquisition mechanisms for the controlling stock of companies; prohibiting employees, directors or stockholders from using privileged information for their own benefit; and access by board members to accurate, important and timely information on the main issues affecting the company.[3]

These are important advances, yet the country has failed to comply with the 20 other recommendations. For instance, Mexico has fallen short in the areas of: "cost-benefit" definition of stockholders' voting; guaranteed public disclosure of timely and accurate information regarding the key issues related to the company's financial situation, balance sheet, ownership and governance; and, even more importantly, the disclosure of the interests of board members.[4]

The individuals who serve on the boards of directors of parastatal companies and trust funds should be both independent and committed to transparency and accountability. But in Mexico it is not unusual to find board members with important conflicts of interest, such as government officials, individuals with vested interests in the sector, or presidents of large conglomerates. Such members may hold back efficient management and limit

[2] See: Florencio López de Silanes, "Corporate Governance in Latin American Firms," in: Alberto Chong, *et al.*, (eds.), *Investor Protection in Latin America* (with A. Chong), (Stanford University Press/World Bank, 2006) and documents by the National Technical Committee for Corporate Government, presided by Adalberto Palma, formal independent member of the IPAB.
[3] OECD, *Principles of Corporate Governance* (Paris: 2004).
[4] See: Georgina Howard, "Gobierno de las empresas: exigencia de cuentas claras," *La Jornada en la Economía*, weekly supplement, July 12, 2004.

the transparent management of the public resources held in trust funds. A paradigmatic example of these conflicts of interests is illustrated by the case of the National Lottery. Francisco Gil Díaz was a member of the board of directors while also serving as the Minister of Finance—the very person directly responsible for regulating Mexico's National Lottery.

In other cases, the board members of government trusts are simultaneously board members of non-profit organizations or have other close relationships and common interests. This creates incentives for public resources to be triangulated, as the public trust fund's board makes a generous donation to a non-profit organization run by the same members of the trust fund's board. The National Lottery example, once again, clearly illustrates the pattern. The Lottery's board donated vast funds from the public trust fund *Transforma México*, which administers the Lottery's resources, to the private foundation *Vamos México,* run by then-first lady Martha Sahagún.[5] The disclosure of this scheme vividly revealed a more general problem with trust funds in Mexico, underscoring the need to guarantee full disclosure of and access to information related to the management and allocation of public resources.

There is a silver lining to the cloud of opacity which enshrouds government trusts. On February 22, 2005, Congress reformed the Federal Supreme Oversight Law (*Ley de Fiscalización Superior*) in order to permit the Supreme Federal Auditor (equivalent to the General Accounting Office in the United States) to audit all trusts and funds which include public resources. Previously, the "independent" nature of these entities had prevented even government auditors from looking into the management of the funds.

In addition, on September 6, 2004, the Ministries of Finance and of Public Administration signed a special agreement which imposes various requirements on government trusts, such as the obligation to publish tri-monthly financial reports, including yields and disbursements. Also, on December 22, 2004, the Federal Institute for Access to Information (IFAI in Spanish) published in the *Diario Oficial de la Federación*, the "guidelines for classification and de-classification of fiduciary and banking operations, as well as for the fulfillment of fiscal obligations carried out with federal public resources by institutions and entities of the Federal Public Administration."[6] These principles establish that government authorities cannot invoke "trust secrecy" as a basis for witholding information about trust funds, because the principle of banking confidentiality applies only to individuals and to private banks, and not to government institutions.

[5] "Donativos de ida y vuelta, estrategia de Vamos México," *La Jornada,* June 18, 2004, p. 5.
[6] OECD, *Principles of Corporate Governance* (Paris: 2004).

Unfortunately, most of the progress in terms of new regulations has still not translated into actual changes in institutional practices. In a public Senate hearing, the Finance Ministry's Undersecretary, Carlos Hurtado, pointed out that although the government "agrees" with transparency, in the case of trust funds, there is supposedly "a legal conflict" which impedes the executive branch from making the information public. The official painted a picture of a bureaucrat caught between a rock and a hard place, claiming that, "if the public servant discloses certain information, he can be open to lawsuits from individuals, trustees or beneficiaries and if he doesn't divulge the information, he can be subject to administrative sanctions,"—overlooking the fact that often the grantor of the trust and the trustee are the same person, and above all, that more than six months earlier his own institution and the Ministry of Public Administration (SFP in Spanish) had signed an agreement to increase the accountability of trust funds.[7]

The Case of the Customs Trust Funds

Such a disconnect between words and deeds was characteristic of the Fox administration with regard to government trust funds.[8] The Customs Trust Funds are perhaps the most emblematic case. Here the government systematically has abused the category of "trust secrets" to prevent independent review of its accounts.

The Supreme Federal Auditor (ASF in Spanish) has found that the Tax Administration System (SAT) was responsible for serious losses of government funds (over 135 million USD) through its operation of Trust Fund 954-8, better known as "Customs 1". This took place through the operation of the private firm *Integradora de Servicios Operativos S.A. de C.V.* (ISOSA), established in June, 15, 1993, on the orders of then-Deputy Minister of Revenue and later Minister of Finance, Francisco Gil Díaz, with the legal advice of Santiago Creel, former Minister of the Interior and at that time partner at the *Noriega y Escobedo* law firm.

ISOSA operated inside the SAT, supposedly with the goal of providing technical and systems support for customs control processes. But in reality, the private company ended up operating as a petty cash drawer for the then-Deputy Minister, who handled the vast

[7] "Imposible, hacer público los recursos de 705 fideicomisos: Carlos Hurtado," *La Jornada,* May, 13, 2005, p. 7.
[8] The Supreme Federal Auditor, Arturo González de Aragón, has stated that during President Fox's six-year tenure, the SHCP "has not charged the fines [nor applied] sanctions against officers or public institutions accused of fund embezzlement." The Auditor's Office has also pointed out that the Ministry of Public Administration has not taken the steps necessary to bar members of the government linked to illegal actions, after being accused by this institution. "Hacienda y SFP toleran la impunidad de 'funcionarios corruptos': ASF," *La Jornada,* September, 29, 2005, p. 12.

amounts of public customs revenue at his own discretion. ISOSA's finances were managed by two private trust funds: *Integradora de Activos* (LASA) and *Controladora de Servicios Integrales* (COSISA), which together with the Customs Trust Fund 1 were established in *Nacional Financiera* (a government development bank, or NAFIN in Spanish). The formally private nature of these funds allowed them entirely to avoid external oversight. During three consecutive years, the ASF identified serious anomalies and billions of pesos in missing payments of the Right to Customs Procedure (DTA) which were not reported to the Finance Ministry after collection. The ASF found that 456 million USD were missing for 2001, 220 million USD for 2002, and 259 million USD for 2003.

After these embezzlements, the auditor tried to conduct an independent review of both Customs Trust Fund 1 and ISOSA, which had received the transfers. Unfortunately, the ASF has not been able to get to the bottom of the irregularities. The Finance Ministry, through the SAT, has used the old strategy of citing the banking secrecy law and refused to hand over the requested information. The government claimed "inexistence" of this information in government files because both Customs 1 and ISOSA were formally private entities. But the alleged private nature of these funds is questionable, since the government development bank NAFIN controls 99 per cent of ISOSA's stock. The executive branch, through the Finance Ministry, also blocked congressional efforts by taking a constitutional challenge to the Supreme Court.[9] This challenge attempted to annul the ASF's observations with regard to the irregular management of Customs 1 because according to the SHCP the funds generated by customs fees are of a private nature and should not be subject to oversight.[10]

Even so, the SHCP evidently knew something was wrong, since in 2006 it liquidated both the Customs Trust Fund and the company ISOSA. In their place, the SHCP founded a new "Public Trust Fund to Manage Payments under Article 16 of the Customs Law" (FACLA in Spanish), which did not exactly stand out for its transparent operations either. The Minister of Finance remains entirely in charge of the operation of the customs trust funds. Neither Gil Díaz nor his successor, Agustín Carstens, have been able to clarify the irregularities related to the management of the billions in public resources generated by the payment of customs fees. In addition, although Gil Díaz made the commitment to return the billions of pesos which he discretionally handled over more than a decade, as of March 2006, the SHCP had only returned 246 million USD out of the total of 935 million USD in irregular payments detected by the auditor.

[9] Controversia Constitucional, 84/2004.

[10] Some good news is that later, on September 7 2005, the Federal Institute for Access to Information (IFAI in Spanish) did eventually order the government to hand over all of the trust funds contracts, financial reports and balance sheets related to Customs 1 (see appeals 906/05 and 685/05).

Conclusion

There is no reason for government trust funds to remain behind a veil of opacity. Through the use of such legal strategies, for decades government institutions and organizations have used public resources without oversight or supervision from accountability agencies. This has led to numerous irregularities and generated enormous losses through the diversion of funds, discretional expenditures, and conspicuous cases of corruption. Trust funds must be held accountable for the use of the money that is entrusted to them by the government. In addition, public officials responsible for using public resources to benefit private interests ought to be held accountable for their actions.