

INDUSTRIAL AND COMPETITION POLICIES IN MEXICO

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INTRODUCTION

Thank you very much, Tom, for inviting me to have this exchange of reflections on competition and industrial policies in Mexico; it is a great honor for me to be here. I would like to share with you a few ideas on the development of industrial and competition policies in Mexico, and, of course, the relationship between them.

This is not going to be very different from the elements brought forward by Ambassador Jones¹—as I said, I can side a lot with his views of what has happened in Mexico over the last few years. Let me focus on the last part of the discussion on competition policy, and on the challenges and problems that we have to tackle in order to bring more efficiency to the Mexican markets.

I would like to list the main messages up front. First, I would like to start with a diagnosis of the Mexican industrial policy from the sixties to the eighties, a long period of import-substitution policies in Mexico. I have to say that some of these policies had a positive effect on the economy, but the protection of domestic industries from international competition created important market distortions and inefficiencies. This is something that happens in many markets: if competition principles are taken out of the market, some efficiencies arise, but the benefits are not transferred to the consumers.

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1. James R. Jones, *Open Markets, Competitive Democracy, and Transparent and Reliable Legal Systems: The Three Legs of Development*, 83 CHL.-KENT L. REV. 25 (2008).

Second, I would like to discuss the shift in Mexico, moving towards a more horizontal policy designed not only to promote competition, but also to define a different kind of industrial policy and to sustain it that way.

Third, and this is the point I was trying to make to Ambassador Jones, despite the reforms, the macroeconomic stabilization, and the subsequent increase of competition and efficiency in the Mexican markets, important inefficiencies and problems still persist. Specially, I would like to focus on a very specific issue: the design of regulation. This is one of the elements that complicate the reform or decision—making processes to control *de facto* powers of the Mexican economy.

Finally, I would like to note some specific measures that could help to deal with these problems. I will go relatively fast because I think that it will be more interesting to have a good discussion with questions and, I hope, answers as well.

I. MEXICO'S INDUSTRIAL POLICY 1960–1980: INWARD-LOOKING INDUSTRIALIZATION

From the sixties up to the eighties, Mexico was able to keep its industry completely sheltered from international competition. Almost any kind of measure one can possibly imagine was used at that time—not only *ad valorem* tariffs, but also official import prices, import controls, licenses, etc.

It was almost impossible to import a commodity into Mexico without getting specific permission from the government. Of course, the companies were able to import all those inputs that they were not able to produce, and there were a lot of distortions. There were very high taxes and tariffs for imported products that were domestically produced and very low (or basically no) tariffs for those goods that were not produced in Mexico. However, these products couldn't be imported by anybody—just by the companies that were using them. Thus, the level of protection was very high.

In this way, the domestic industry was sheltered from competition, and that was the name of the game for many years in our economy. The result was a very inefficient industrial sector, distorted markets, and low consumer welfare. Also, entrepreneurial creativity was not something that could be perceived in the Mexican economy. This situation resulted in agents that were able to exert considerable political pressure in order to maintain the closed economy. As a consequence, there were low quality products, few options, and high prices: just what can be learned from any textbook.

II. INDUSTRIAL POLICY SINCE THE MID-1980'S

The shift started in the mid-eighties. Mexico became part of the General Agreement on Tariffs and Trade (GATT) in 1986. At that time, people thought that to be a member of GATT was the same as opening the economy, which is not necessarily true. There are many countries in the World Trade Organization (WTO) that are as closed as they have always been.

It was just a signal to the private operators that the idea to unilaterally open the economy was a long-term policy. That is the reason Mexico entered the WTO. It was not because Mexico was going to open the economy through the GATT—the objective was to send the signal that the unilateral opening of the economy was going to be a long-term policy. That is because at least twice before we had tried to open the economy without success.

What I call the first generation of reforms included macroeconomic stability, trade openness, and a modernization of the regulatory framework. What I call the second generation of reforms included the application of some instruments with a completely different view of industrial policy. The objective was not to pick certain sectors of the economy and promote them at the expense of others. It was just to use, in a very efficient way, horizontal instruments like standardization and metrology. The reforms also included a new law of property rights protection. Furthermore, the reforms included a new law to open the economy for foreign investments. Finally, the creation of regulatory agencies was a key factor.

Something I would like to stress is how those agencies were created, how they have been working, and what the institutional framework was for them.

III. INSTITUTIONAL DESIGN OF REGULATION

The opening of the Mexican economy, unlike most countries undergoing this process, did not include the service sector. Very important sectors, such as transport, telecommunications, energy, and financial services were not opened.

The case of energy is a special one; it remained closed not because it is a service, but because it is a sector that by constitutional mandate is managed by the State. However, all these sectors share a common feature: they have broad effects on the whole economy.

If you do not have competition and efficiency in telecommunications, for example, all the consumers and all the companies, no matter what, are going to be affected. The same thing happens with transport and with fi-

nancial services: every single company and consumer in any economy has something to do with all these sectors. Thus, if you have inefficient systems in those sectors, there will be a lack of competitiveness, and this is what we are seeing in Mexico.

Let's take, for instance, the transport sector. We are spending for transport services in Mexico more than double what is spent in the U.S. We have inefficient railroads in bad condition, and our reports show they were badly regulated. Railroads were then privatized, and the productivity in the railroad sector increased enormously in the first years because they could not be worse than they were before they were government-managed: very inefficient, very expensive, and where not even for a moment did anyone even dream of using the railroad in Mexico.

Now we have three operators that are much more efficient. But the problem is that the rules that oblige them to compete are not being applied. And this is why this original productivity increase has continued that way over the past few years.

The only service I wouldn't consider inefficient in the transport sector—and it is a good example of how things can change for the better—is the airline industry. The Federal Competition Commission did not allow the privatization of Aeromexico and Mexicana, the two major airlines in Mexico, as one firm. That was, of course, the objective of the Ministry of the Treasury because it wanted to get the most money from the sale of the companies. But we did not allow it, and thus we opened the possibility for low cost airlines to enter the market. As a consequence, air ticket prices have decreased as much as eighty-five percent in many routes. Also, more than fifty percent of the people who are using airlines today in Mexico are people who have never been in airplanes before. This is incredible, and this was just over the last year. So this is a good example of good decisions in the market, and such an important market can have a big social impact.

In telecommunications, Mexico is one of the most expensive countries in fixed line telecommunication tariffs. Some of these countries are efficient, some of them are not. Furthermore, we are one of the most expensive countries for business activities. For residential prices, we are about in the middle. Internet coverage is very low and very expensive. There is not enough competition in telecoms, and this is a big problem in our country.

Another example where there is not enough competition is in the financial services sector. We have a very highly concentrated sector, and we have a very low level of financing to companies in Mexico. We are not doing well in this sector because we are one of the most expensive countries in these regulated sectors: just look to natural gas prices. So part of the

problem—and I'm not going to say that it is the only one—is the institutional setting of the sectoral regulators.

Any sectoral regulator has to deal with the Ministry and with horizontal regulators. It has to deal also with external actors like Congress, the judicial branch, and the consumers. Problem one, to depend on the Ministry brings you very close to political pressures—hence it is not a good idea. Problem two, you should not disconnect the sectoral regulator totally from the horizontal regulator, otherwise there is going to be a crisis in the decisions of the government. And third, there is a lack of surveillance that favors regulatory capture; there is a lack of contact with external actors like Congress, the judicial branch, and so on.

IV. MEASURES TO IMPROVE REGULATION

What I would propose, and I think this would benefit the institutional setting in Mexico because the problems that I just raised previously are precisely what we are facing, is first, autonomy to the sectoral regulators. This is something that does not happen in Mexico, except for the central bank. The financial regulators, telecomm regulators, and energy regulators are all sectorized, and they all depend on a specific Ministry. That's a big problem.

Second, we have to have some coherence with horizontal regulators. The Federal Competition Commission or the Federal Commission for Improvement of Regulation have to work with all sectors, so it is important to have better coordination to increase the efficiency in the design of public policies.

Finally, you need horizontal accountability. You have to force sectoral regulators to face Congress, to face consumers, and to do much better work with the judicial branch. In my view, normally when one discusses public policy, one tends to take as given the institutional framework, so the point that I would like to finish with is that the institutional framework is key. It is very important.

So you could have even a law that is far from being perfect, but if you have a good institutional framework you can do relatively better. But if you have a very good law with a very bad institutional framework, the law is absolutely useless.

QUESTIONS

1. *I'm just curious as to what the impetus was for the change. What has given you the possibility to become as effective as you have?*

One of my main concerns is that since, I would say 1997, the first time the executive branch lost control of Congress, we have not been able to introduce important reforms in our time. Now we have a more efficient democracy in Mexico without any doubt, but we still have to move to a more democratic system. At the same time, we have a very concentrated economy, so we have very few but very strong factual powers that have understood how to deal with a much more plural and open political system, so they are very efficient in working for their cause. And the government has not been able to be as efficient as these guys. So what happens is that many of the changes in the law that have taken place in the last few years have been basically geared to increase the privileges that these groups have had. And that has imposed a very strong cost in terms of productivity.

I would say that one of the very few reforms that passed in the last few years was the competition law reform that was approved in April of last year and entered into force in June of last year. But it was a very open, very vivid, and very public discussion, and it was when the elections were taking place and, you know, something that originally was perceived as a very bad time to discuss competition turned out to be the best situation because of the fact that it was so popular. A change in competition policy was needed, and it was very public that there was a need for that change, and it was also the process of elections at that time, so the parties had to face the public, and they had to push forward for these reforms. It was a very interesting situation.

2. *How are the regulators selected? Is there a backing cause as through the public to the system, to the legislative system? The other question is relative to pay scales, the salary structure of the regulators relative to that of the civil service, not necessarily vis-à-vis the private sector. The third question is related to the community of non-governmental organizations (NGOs), because in a country like India, NGOs have been very active and have made the government more accountable.*

The three questions are important as well. As for the elections of regulators, in some cases, in particular the central bank, the President of the Republic has the power to name the governor of the central bank, but a green light from the Senate is needed. As for the Federal Competition Commission (CFC) and the telecommunications regulator, for example, it was something recently discussed in the Supreme Court. There was a big

discussion about the power of the Senate to approve the commissioners of deconcentrated executive agencies.

Some laws included dispositions which ordered the Senate to ratify the commissioners. However, after a constitutional trial, the Supreme Court of Justice of the Nation established that the deconcentrated agencies of the executive—for example, the Federal Competition Commission and the Federal Telecommunications Commission—are exclusive branches of the executive power, therefore the President of the Republic has the exclusive power to designate commissioners. In order to change this situation, a constitutional change is needed.

As for the salary structure, it is an issue that has recently changed. The salary structure of the government in Mexico is not so deficient. In the U.S., for example, the actual salary might be even lower than the actual salary of some people in the government of Mexico. The only difference is that when somebody gets fired or retires in the U.S., he gets much more money. The level of permanent income in the U.S. is higher than in Mexico. In Mexico, there is a short-term higher income. The income level of the regulatory agency commissioners is a little bit lower than other executive ministries. The difference is that many commissioners are named for a ten-year term. In addition, recently there was an important income decrease for the higher offices of the executive branch.

There are basically no NGOs in Mexico that defend consumers. NGOs are very important and they should be promoted. However, currently no regulator is promoting the creation of NGOs.

3. You mentioned the financial sector. The sector has changed quite a bit over the last three or four years. The Banking Commission has become more independent and new institutions are coming in. I was wondering about the role of your agency in these changes and how you see this development.

That's a very interesting question. As for the financial sector, the Federal Competition Commission issued a public policy recommendation on the pension funds system in November of last year. The CFC stated that the system still faced challenges related to an inelastic demand and unexploited economies of scale that prevent pension funds administrators (Afores) from competing efficiently.

This recommendation was very much criticized. My impression is that when the CFC went against the Ministry of Transport and Telecommunications, the Ministry of Finance got on the Competition Commission's side. But the first time the CFC criticized the job of the Ministry of Finance, they went public and criticized our recommendation. However, this recommen-

dation was one of the triggers for Congress to approve, in March 2007, changes to the pension system law in line with the CFC's proposals.

The CFC stated that the main problem was related to the demand side, not the supply side. Consumers in Mexico are not so well educated. In pension funds, the largest number of consumers are guys with very low education, mostly from the manufacturing sector. Even very highly educated people don't understand very well pension indicators such as returns, risk, commissions, etc. What we have perceived in the Federal Competition Commission is that the demand does not respond to price changes as it responds in other markets where consumers can understand easily the differences in price vectors.

So, the fact of having many suppliers does not mean that there is more competition. The way the pension system was built was such that there was a "flow commission." This commission was about fifteen to twenty percent of what consumers put in their accounts when shifting from one Afore to another. Some consumers assumed that they would be better off later on by changing from Afore, but the reality was the opposite. The CFC said this in the recommendation. Out of the 3.5 million changes from one Afore to another that took place last year, seven out of ten moved to more expensive companies in terms of commissions or returns. In addition, fifty-five percent of the costs of those companies were on advertising.

Currently, the CFC is preparing other recommendations on other markets in the financial sector. What we have seen is that the efficiency of the financial system has increased substantially. However, the prices of the services have not. So, the benefits of the efficiencies are not transferred to the consumers.

Thank you very much.