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# REGULATORY TRANSFORMATION IN MEXICO, 1988–2000

## CASE STUDIES ON REFORM IMPLEMENTATION EXPERIENCE

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# EXECUTIVE SUMMARY

The situation in Mexico two decades ago was not unlike that facing many countries today. The economy was heavily regulated and protected. Industries and services in many areas were shielded from foreign and national competition, and the federal government operated thousands of enterprises in a range of sectors. But in the late 1980s the government launched a major reform effort aimed at changing all that.

## The Reforms in Mexico

Indeed, during 1988–2000 the Mexican government devoted most of its political energy to transforming the business environment. It undertook reforms aimed at opening markets, privatizing state enterprises, and redefining the role of the state through deregulation and the building of new capacities for high-quality regulation. Early reforms unleashed forces that drove the momentum for later reforms. The opening of markets, for example, led to a need for greater competitiveness and thus lower regulatory costs for businesses, which fueled regulatory reform several years later. Failures in privatization, by contrast, deepened suspicions about the beneficiaries of market reforms.

The government-wide regulatory reform program was intended to reduce regulatory costs and barriers to entry while increasing the quality and transparency of the public sector. To achieve these results, the government introduced a range of new institutions and procedures. These included the Economic Deregulation Unit, the Federal Competition Law, and amendments to the Federal Administrative Procedures Law to protect citizens against bad regulation. They also included the creation of a registry of the formalities to which businesses are subject—an initiative that led to a 45 percent reduction in the procedures required of businesses—and the adoption of regulatory impact analysis to lower regulatory costs.

These successive reforms brought about an enormous change in the conduct and perception of the federal public administration in Mexico—and greater certainty for businesses and individuals. The reforms to transform the role of the state in Mexico's economy are probably directly

linked to positive economic developments. The private sector share of Gross Domestic Product (GDP) rose from around 60 percent in 1980 to nearly 90 percent by the end of the 1990s. Between 1983 and 2000 non-oil exports jumped from $12 billion to $150 billion, and trade grew from 26 percent of GDP to 64 percent. Foreign direct investment levels more than doubled from 1993 to 1994 and persisted at similar levels even in the face of the 1994–95 economic crisis.

Improvements in governance were also recorded. Governance indicators published by the World Bank point to high marks in regulatory quality for Mexico from 1996 to 2000—and to substantial improvement in government effectiveness, rule of law, and control of corruption.

## Lessons of the Reforms

Mexico's experience offers lessons for other governments that face the difficult challenge of organizing, implementing, and sustaining government-wide, multi-year programs of economic reform. Understanding which factors supported success, and which shortcomings undermined it, can help pinpoint good practices in reform.

### Success Factors

- *The reforms were guided by a comprehensive plan with mutually supportive elements.* The pillars of reform were mutually supportive—market openness increased pressures for economic liberalization, which led to reforms in public sector capacities for good regulation. This logic sustained momentum as allies of reform were created—and helped to push the next phase along.

- *High-level political support was translated into action.* Clear and sustained support at the highest levels of the federal government resulted in clear mandates, adequate resources for reform institutions, and the dedication of high-quality personnel in key ministries.

- *A top-down approach—guerillas in the bureaucracy—was used to trigger reforms.* To help overcome resistance to change in lower levels of the public administration, the reforms were orchestrated by a small group of skilled reformers assembled by the president and placed in key government positions.

- *The government adroitly used crisis as an opportunity to set the agenda for reform.*

- *The reforms were based in an explicit regulatory policy supported by trained professionals in a central reform body.*

- *The reforms made effective use of international experience and best practices.* Mexico relied on its membership in the North American Free Trade Area and especially that in the Organization for Economic Cooperation and Development (OECD), which it joined in 1994, to learn about best practices in regulatory reform.

- *High-level task forces delivered quick reforms and were able to overcome entrenched resistance.* To launch the reforms, the government created focused executive units for each cross-cutting policy. These units were needed to trigger changes, break administrative and cultural molds, and provide new capacities to the public administration.

- *A mix of different mechanisms were used to compensate losers.* Dealing with interest groups opposed to reforms required a pragmatic mix of communication and education, institutional alliances, compensation to aid adjustment in the short and long term, and the courageous exercise of leadership and power. Mexico relied on all these mechanisms.

- *Linking reforms to international obligations such as the North American Free Trade Agreement (NAFTA) helped drive and anchor reforms, preventing backtracking.* NAFTA provided an institutional framework for

reforms, establishing terms and obligations that could not be broken without incurring significant costs.

### Shortcomings

- *The reforms suffered from inadequate sequencing.* The reform strategy and monitoring mechanisms suffered from various deficiencies which hindered their sustainability.

- *Monitoring was neglected, leading to misperceptions and false expectations.* The lack of systematic, ongoing evaluation led to an amnesia in which society and politicians forgot or minimized the benefits of reforms while emphasizing the costs, reducing support for long-term efforts.

- *Poorly developed competition and regulatory frameworks for privatized infrastructure services undermined support for the entire reform process.*

- *Short-term gains were not properly weighed against longer-term sustainability in some cases.* Expecting that economic efficiency will be the only factor taken into account during structural reform is politically unrealistic. But the Mexican experience suggests that success depends on giving high priority to competition and economic efficiency.

- *The design of reforms often overlooked the different needs for their implementation.* The change orchestrated in Mexico was broad, ambitious, and carried out extremely quickly. But some legislative reforms never reached full implementation, and the speed of reforms inevitably led to great difficulty in consolidating the gains.

- *Lack of transparency and inadequate communication about the goals, benefits, and costs of reforms reduced their acceptance over the long term.* In retrospect, earlier and stronger efforts were needed to institutionalize many of the reforms and communicate them to society.

- *Inadequate quality of human resources and administrative processes, paramount in implementing reforms, slowed progress.* Difficulties in modernizing and depoliticizing the public administration in Mexico created an important obstacle to the reforms.

- *Political and public support was too fragile to sustain the course.* Mexico's difficulties in moving forward with further reform may suggest that the approach to setting the purpose and direction of change was too top down and autocratic, compromising the continuity and coherence of reform.

### Lessons for Other Countries

- *The depth of the political, social, and institutional reforms required to carry out structural change is linked to the overall development of society.* By the early 1990s the corporatist model was changing in Mexico, and reformers did not appreciate the shift. It took the 1994 peso crisis for them to recognize the need for a more open and accountable approach. Beginning to establish the foundation for a new model of reform required many years.

- *As the reform process advances from launching to implementing change, involving different stakeholders along the way, political support needs to take different forms.* At the outset political support for reform will mean pushing, commanding, and expending sheer political capital in overcoming resistance. But as implementation begins, political support will mean providing guidance and leadership, ensuring more open and participative approaches, and defending the reform institutions that will be under fire.

- *It is important to design and create institutions that will support reforms in the long term.* To compensate for shifts in political support, it is

vital to contemplate a phase of institution building—centered on developing and financing human resources—during the design of reforms.

- *International agreements can anchor and drive reforms.* Because an international treaty with important partners, such as NAFTA, limits the discretion to unilaterally reverse reforms, it can work as a powerful "ratcheting" mechanism toward comprehensive reform.

- *Market-based reforms require stronger transparency and accountability, which take time to materialize, but new communication technologies can support institutional change.* As reforms slowly sink in and are internalized in the political and administrative culture, adherence to principles of transparency and accountability becomes vital to supporting the market and maintaining trust in a modern regulatory state.

# 1. INTRODUCTION

In 1988 Mexico launched reforms that transformed the regulatory relationship between the state and the market across the whole of government. The process that propelled these efforts enabled Mexico to carry out a coherent, multiyear regulatory reform program with economywide effects. This case study examines the strategies of Mexico in undertaking this ambitious reform program as well as the events and stakeholders that shaped the reform efforts.

The two presidential administrations in power between 1998 and 2000 devoted much of their political energy to redefining the role of the state—minimizing its intervention in the market and transforming its regulatory role. Although strategic goals were not clearly articulated, the ultimate aim was to shift the frontier between the public and private sectors. In pace, scope, and depth the regulatory reforms exceeded those of almost all other OECD countries except the transition economies in Central and Eastern Europe.

The reform process was rooted in three mutually supportive pillars:

- Liberalization of trade and investment, anchored in the North American Free Trade Agreement.
- A vast privatization program designed to reduce the government's direct participation in the economy, increase private sector confidence, and enhance economic efficiency.
- A regulatory reform program with several objectives—to cement the regulatory changes required for a modern, market-oriented economy (transforming the public sector from an owner to a regulator and promoter of private enterprise), to broadly promote competitive markets by making it easier to start and operate businesses (necessary to confront growing competition in tradable goods), and to craft an improved regulatory framework for recently privatized industries (generally nontradables not subject to trade-induced competitive pressures).

# 2. CONTEXT OF THE REFORMS

Two decades ago the Mexican economy was heavily regulated and protected. Industries and services in many areas were shielded from foreign and domestic competition, and the federal government operated thousands of enterprises in sectors ranging from hotels to transport and mining. Exports were limited, with most industries focused on internal markets. In the 1980s a collapse in oil prices and default on a massive external debt, followed by five years of economic stagnation, triggered a major shift in this economic model. Mexico was one of the first Latin American countries to adopt market-based principles as a cornerstone of economic development.

## The Broad Context

The changes began under the administration of President Miguel de la Madrid, which came to power in December 1982. Faced with the task of correcting fiscal imbalances and dealing with external pressures created by the debt crisis that had erupted earlier that year, the government decided to abandon the import substitution model that had been in place for nearly 30 years. This crucial policy shift was part of a worldwide trend. Later, the fall of the Berlin Wall in 1989 galvanized the administration of President Carlos Salinas at the highest levels. Seeing the bold changes occurring in Eastern Europe and Russia, many policy makers and analysts urged the government not to "miss the boat" of history.

Meanwhile, the social and political environment was also shifting, and the Mexican polity was finally beginning to show some democratic vigor. The incumbent political party had been in power for nearly 60 years, and government decisions were centralized in the hands of the president. The highest level of the executive branch wielded much influence over the legislative and judicial branches. In addition, the president nurtured a consultation model allowing representatives of the business community and unions to participate in exclusive, high-profile social pacts.

But new voices and demands were emerging, and discontent took shape in the broader society. The presidential elections of 1988 saw a strong populist challenge as suspicion of voting fraud led an array of opposition groups to take

to the streets. In the following years this movement grew, demanding more transparency and accountability from the state and especially the executive branch.

## The Specific Context

Mexico progressively opened up its economy through such steps as joining the General Agreement on Tariffs and Trade (GATT) in 1986.[1] The government launched a fiscal austerity program to control inflation and reduced the state's direct participation in the economy through a program of privatization and market liberalization. At the core of these reforms was a new strategy of market openness. Domestic reforms were underpinned by international commitments as Mexico joined not only the GATT, but also the Asia-Pacific Economic Cooperation (APEC) and the OECD and signed free trade agreements.

This move toward market openness did not happen in isolation. Mexican leaders had watched the Asian economic successes of the 1970s and 1980s and had seen the positive effects of trade liberalization in the rapid growth of the maquiladora sector (in-bond assembly plants that export finished products primarily to the U.S. market).[2] Most other Latin American countries were also shifting their economies toward a more pro-market, pro-trade orientation. Competition for international capital and investment was strengthening, and in the absence of concrete advances in multilateral trade negotiations (the Uruguay Round), Mexico sought to engage an array of nations in preferential trade and investment agreements.

Results were slow to appear, however. Reforms were complicated by continued downward pressure on the price of oil (a major Mexican export), a stock market crash, and a run on the peso in 1987. Mexico's economy continued to suffer from relatively low productivity growth, investment, and industrial production.[3] And a small number of firms with political clout in each sector continued to dominate the Mexican market. These disappointing results were linked to a combination of factors: the timidity of reforms, a political economy vulnerable to special interests, concentrated market structures, and inflexible labor laws that prevented economic adjustment.

Moreover, the public sector continued to draw precious resources from the already meager and oil-dependent budget. Employment in the federal government had ballooned to nearly 2 million workers by 1988, up from 1.5 million in 1986. Administrative offices were overstaffed, and state enterprises, with unionized workers, accounted for 40 percent of federal government employment.

But the lack of early results did not stop the reforms. On the contrary, the reforms expanded and deepened. Since 1987 and over the next 15 years, Mexico made regulatory reform a central element of its broader transformation from an inward-looking economy to an open, market-based one. Regulatory reform has steadily proceeded, at first because of and later despite the external shocks and macroeconomic upheavals that accompanied this transformation. Indeed, regulatory reform may have helped reduce the severity of economic shocks by increasing the flexibility of the economy.

1 Between 1982 and 1988 the share of imports subject to special licenses was reduced from 100 percent to around 20 percent, and the average tariff from 27 percent to 10 percent (Blanco 1994, 40).

2 The maquila program, set up in 1966 to alleviate high unemployment in the border region, slowly expanded to become a key tool for attracting foreign investment and technology. The program allows 100 percent foreign ownership of firms and temporary importation, without payment of import taxes, of foreign goods into Mexico, where they are assembled, manufactured, or repaired and then exported, either to the country of origin or to a third country. Between 1986 and 1992 employment growth averaged more than 10 percent a year in this sector, while export growth exceeded 20 percent (Blanco 1994, 45–46).

3 Studies have estimated productivity growth in Mexico in the range of 1–2.5 percent a year in the 70s and in the 80s, compared with 3–4 percent for Hong Kong (China), Taiwan (China), and Korea (Lustig 2002).

# 3. CONTENT OF THE REFORMS

In 1988, the new administration of President Carlos Salinas decided to decisively accelerate reform. Its approach was to deepen the reform strategy by adding international trade negotiations and a more intense program of domestic economic deregulation. The first was necessary to break through domestic opposition to reform and to attract investment; the second to facilitate the flow of goods and services through the economy by eliminating regulatory bottlenecks, and to revive domestic and foreign investment.

The reform process centered on three main pillars:

- Consolidation of trade liberalization, mainly through the negotiation of a free trade agreement with Mexico's largest trading partner, the United States.
- Expansion of the privatization program to increase economic efficiency and restore the private sector's trust in government.
- Gradual implementation of a government-wide regulatory reform program to speed adjustment, eliminate bottlenecks in the economy, and increase the transparency of the public sector.

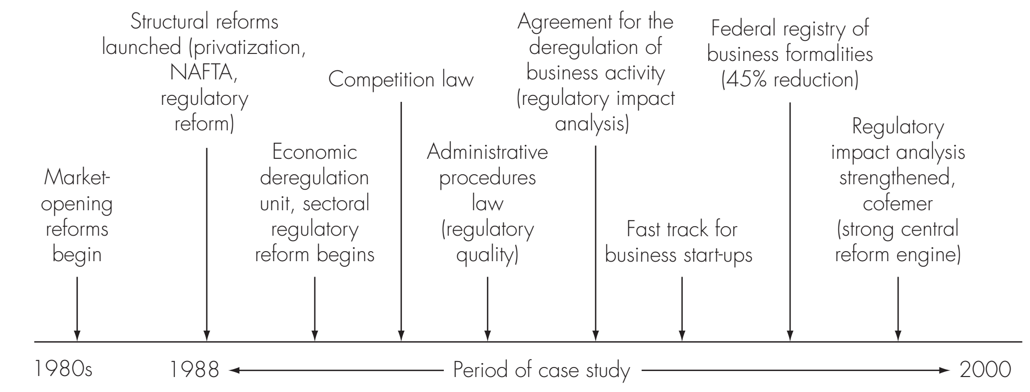
Underpinning these reforms were a range of new institutions and procedures to carry out and sustain regulatory reform in Mexico (Figure 1).

## The First Pillar: Using Trade Agreements to Anchor and Drive Reform

At the core of the new thinking was the use of external mechanisms to anchor and drive reform. The administration persuaded Mexican society—and, just as important, the United States—to support NAFTA, a trade agreement largely inspired by the one just finalized between the United States and Canada (Box 1). For Mexico, a major rationale for pursuing NAFTA was to transform its image, convincing the domestic and foreign private capital markets that it was a trustworthy business partner. For example, the state's direct intervention in the

FIGURE 1

## Timeline of Events Included in the Case Study




BOX 1

### Negotiating the North American Free Trade Agreement

Mexico and the United States began formal negotiations of a free trade agreement in August 1991. Canada later insisted on participating in the new Mexico-U.S. treaty, which became the NAFTA. The negotiation of the main body of the agreement was concluded in December 1992. Once labor and environmental side agreements were incorporated in 1993—mainly at the behest of the new U.S. administration of President Bill Clinton—NAFTA received legislative approval in all three countries in November 1993 and entered into force on January 1, 1994.

After agreeing on a basic text in August 1992, the Mexican government, under orders of the president, launched an effort to disseminate NAFTA throughout the country. Negotiators held 44 forums on NAFTA in 27 of the 31 state capitals and in the Federal District. In addition, they held 14 forums in the Senate to ensure that legislators were fully informed before the final vote.

economy and its traditional discretion (granted by the Constitution) in limiting property rights had been a source of uncertainty and distrust for the private sector. As a stable external mechanism, NAFTA played an important role in limiting the discretion of the state in defining trade policy and in expropriating private property (see Elizondo 2001).

The signing of a trade agreement with the United States also served as a mechanism to lock in earlier reforms and commitments with Mexico's main trading partner. It ensured future access to the North American market and guaranteed the permanence of Mexico's new policy of market openness. In addition, the treaty included important measures on protecting investment and intellectual property and new disciplines in consultation and trade disputes. These established credible and irreversible obligations on transparency and investor protection.

Domestically NAFTA, along with membership in the OECD in 1994, was sold as a ticket to enter the "rich countries' club." Just as accession to the European Union has been an important catalyst for difficult reforms in many European countries, NAFTA helped focus attention on the structural reforms Mexico needed to become globally competitive (see Solchaga 2004).

NAFTA required setting up new institutions and adjusting existing ones that were helpful in sustaining regulatory reform. An early and important decision was to shift all trade policy, including international negotiations, from the Foreign Affairs Ministry to the Ministry of Trade and Industrial Development (Secofi). Trade was considered part of Mexico's national economic policy, not its foreign policy, and the idea was to isolate it from potential "contamination" by politically tainted international issues or obligations.[4] In practical terms, this meant placing the Mexican missions to the GATT, OECD, APEC, and the like under the control of Secofi.

To coordinate public sector responses to NAFTA, the government established the Interministerial Commission for the Free Trade Agreement, composed of the ministers of trade and industrial development, foreign affairs, social development, finance, and labor and representatives of the Office of the Presidency and the Bank of Mexico (the central bank). While Secofi retained full responsibility for the negotiations, the commission provided a channel for ministries to communicate their interests in the negotiation agenda.

Because building the confidence of the private sector was so vital, the government encouraged a new collaborative relationship through the NAFTA Advisory Council, made up of representatives of labor, agriculture, academia, and business. The council's role was to discuss priorities and interests in the negotiations and keep its constituencies informed about progress.

4 Mexican relations with the United States cover a large array of complex issues, including immigration, drug trafficking, urban development, and environmental concerns along the border. To deal with trade in isolation from all other issues and on its own merits, it was deemed best to maintain the authority within Secofi, reducing the probability that trade opening would be linked to concessions in other areas. Major trading economies commonly use such an institutional structure—such as Japan (Ministry of International Trade and Industry), the United States (Office of the United States Trade Representative), and Europe (Directorate-General for Trade)—precisely to limit contamination of trade policy by foreign affairs and politics.

The private sector also reorganized itself to participate in the reforms. The Business Coordinating Council, the most broadly based business association in Mexico, established the Council of Foreign Trade Business Organizations to serve as the principal link with the public sector during the negotiations. The new entity presented the positions of each productive sector to Secofi and actively participated through a "side room" strategy that allowed it to respond rapidly to changes in proposals and strategies during the negotiations.

NAFTA was not the only new external commitment that Mexico entered into. Others included its membership in the GATT (1986) and unilateral tariff reductions; membership in APEC (1993) and the OECD (1994); and free trade agreements with Chile (1992), Bolivia (1995), Colombia and Venezuela (1995), and Nicaragua (1998).

## The Second Pillar: Expanding Privatization to Support Structural Reform

Opening the economy to international markets will produce few benefits—and even amplify the pains of adjustment—if the economy is too rigid to respond because of either government ownership or regulatory constraints. To enable Mexico to take advantage of the opportunities created by the trade agreements, the government had to intensify and deepen structural reforms in the economy (efforts supported in part by resources and advice from the World Bank Group).

The government began a fresh round of privatizations, this time focusing on the reprivatization of banks that had been nationalized in 1982 and the liberalization and sale of public sector infrastructure such as rail, ports, highways, and telecommunications. It complemented this policy with a major agenda of economic deregulation, inspired in part by the Thatcher and Reagan initiatives in the United Kingdom and the United States and the Chilean process. But unlike privatizations of tradable goods and services companies, the sale of

public service companies requires heavy doses of reregulation. These efforts were therefore linked to major constitutional, legal, and regulatory reforms.

Through liquidations, mergers, transfers, and sales, the government reduced the number of state-owned companies from 1,155 in 1982 to fewer than 200 in 1996. That dramatically changed the composition of public sector employment and allowed the government to pay down a significant share of its debt. (In the late 1990s, however, the state still owned major infrastructure sectors).

## The Third Pillar: Reforming the Regulatory Framework

Regulatory reform was an important new feature of the 1988–2000 reform process. The initial goal was pure deregulation: to eliminate regulatory barriers and burdens, liberalize protected sectors, remove economic bottlenecks that were limiting the gains from greater market openness, and through these steps support the trade negotiations that were picking up steam. The gains from unilateral market opening in the 1980s were inadequate, and the government needed to show more results.

Awkwardly, until 1995 the regulatory reforms were promoted separate from the privatization process. This poor practice showed that designing regulation for privatized sectors was not among the main concerns of officials carrying out the privatization efforts.

### Early Strategies for Regulatory Reform

To implement the radically new policy process of regulatory reform, the government assembled a small, high-level group of professionals—almost like a special forces team—outside the traditional structures of the bureaucracy. These professionals, around 15 economists and lawyers, formed the Economic Deregulation Unit (UDE), created in 1989. The UDE operated under the general purview of the powerful trade ministry (Secofi) and was directly accountable to the trade minister. (For a chronology of regulatory management initiatives and details on major sectoral regulatory reforms undertaken in 1988–2000, see Appendixes 1 and 2.)

The UDE directed much of its efforts toward fostering efficiency in the provision of non-traded goods and services that are shielded from international market competition. It used an opportunistic strategy, selecting economic sectors where deregulation could yield large gains at little political cost, such as natural gas, or where inaction would result in excessively high costs, such as road freight.

Early achievements helped facilitate private participation in such areas as:

- Trucking and bus transportation (1989–90), by eliminating price and route restrictions,
- Electricity (1992–93), by providing the legal basis for cogeneration and self-supply by independent producers,
- Ports (1991–93), by creating privately run, integrated port administrations,
- Land tenure (1992), by allowing the sale of small plots and promotion of agribusiness ventures.

Consistent with experience in many countries, however, the UDE soon found that it could not address the regulatory problems facing the economy unless it moved from a strategy of deregulation to a broader and more sustainable strategy of regulatory improvement (OECD 2002). The Mexican economy was not only overregulated; it was also underregulated in some areas and poorly regulated in others. More important, ministries still had a regulatory style that was top down, interventionist, and nontransparent.

The new strategy was aimed at improving the regulatory environment for private sector activity

by creating appropriate market rules and institutions and building more effective and efficient governance. The UDE began to devote great efforts to horizontal regulatory reforms that benefited virtually all economic sectors—for example, designing regulatory frameworks for consumer protection, technical standards, and competition policy.

As the UDE gained experience, it started developing tools of regulatory governance. Changing rules without changing the *way* ministries regulated could not sustain the advances made: ministries would gradually re-regulate and once again expand their powers. The reform had to be more systematic to prevent regulatory backtracking—that is, it had to control the “flow” of new rules as well as the “stock” of old ones. And it had to impose minimum quality standards on new regulations.

This policy shift toward more comprehensive regulatory reform was supported by the business community. After nearly a decade of trade liberalization and the entry into force of NAFTA in 1994, businesses faced growing market competition and had become increasingly worried about the anticompetitive effects of new and existing regulations. A new sense of urgency emerged when Mexico’s financial system collapsed in December 1994, only a few days into the new administration of President Ernesto Zedillo. In that month the currency was devalued by more than 50 percent, and in 1995 the economy contracted by 6.2 percent.

As often happens in times of economic crisis, the business sector clamored for protection and subsidies and for an “industrial policy” involving generous state aid. But it also demanded concrete measures to reduce red tape and petty corruption, which were particularly burdensome for start-up firms and small and medium-size enterprises.

Meeting the demands for protection and subsidies was beyond the government’s power. Scarce public funds allowed little room for subsidies to private firms. And NAFTA had locked in tariff eliminations and limited the ability to protect domestic industry through nontariff barriers. So the government focused instead on reducing the cost of doing business through intensified regulatory reform, a strategy aimed at helping Mexican firms expand their exports and transform themselves into engines of economic growth.

### Toward More Systematic Regulatory Reform

In a move designed to make the regulatory reform program more systematic and transparent, President Zedillo issued a decree, the Agreement for the Deregulation of Business Activity, in December 1995. Now with a broader mandate, the UDE established a clear review process for proposed and existing regulations. This process required the sponsoring agencies to justify proposed regulatory measures on the basis of efficiency.

In addition, the UDE continued to propose reforms in specific sectors, even without the approval of the responsible line ministry. It also signed cooperation agreements with most Mexican states to promote regulatory reform at the state level, to provide technical assistance on request, and, through coordinated federal-state efforts, to make it easier for new businesses to start up.

One of the UDE’s major achievements was to create a complete inventory of business formalities—rules and forms required to start and operate a business, such as licenses, permits, and other authorizations. The process of compiling this inventory, the Federal Registry of Business Formalities, involved reviewing all business formalities (except those relating to taxes). In addition, the UDE required ministries and agencies to submit a justification for each one—a requirement that shamed officials into culling unneeded, duplicative, and forgotten formalities.

The process led to the elimination of 45 percent of business formalities by 1999, reducing red

tape and the discretion of front-desk public servants and inspectors. By reducing and streamlining the federal formalities required to start a new business, the changes not only made business start-up far easier; they also virtually eliminated a significant source of corruption.

Other initiatives included transforming licenses into notifications, exempting or simplifying compliance by small firms, and simplifying and streamlining inspection procedures. The UDE also began to work with local governments to establish state and municipal registries of formalities.

The new regulatory management system required a cultural shift in Mexico's rigid and legalistic public administration. The bureaucracy was unaccustomed to the "delays" associated with controls to ensure the quality and transparency of regulation. But with some exceptions, the new processes were able to overcome opposition thanks to support from the president's office and, crucially, from the president's legal counsel (which considered the UDE a vital filter in ensuring the legal quality of regulatory proposals submitted for the president's signature). To further support the UDE in delivering its new mandate, the government created the Economic Deregulation Council, with representatives from the government, business, labor, and academia.

Conflicts were resolved through the government hierarchy, with the UDE acting as the monitor. Laggard ministries were identified, called to account, and encouraged to accept the new regime by the Economic Deregulation Council and in Cabinet meetings. Also playing a key role were a series of specialized ad hoc working groups, with members designated by the Business Coordinating Council and the Economic Deregulation Council. This national forum for discussion of regulatory proposals helped to consolidate the power and prestige of the UDE and was instrumental in exposing and overcoming ministerial reluctance and delays.

After several years' experience in implementing the regulatory reform program, and prompted by recommendations from the OECD and an approaching presidential election in 2000, President Zedillo moved to institutionalize the policy and speed its implementation through reform of the Federal Administrative Procedures Law.[5] With this reform, the UDE was transformed into the Federal Regulatory Improvement Commission (Cofemer), with an expanded mandate, legislative backing for many of the UDE's powers, and new enforcement powers.

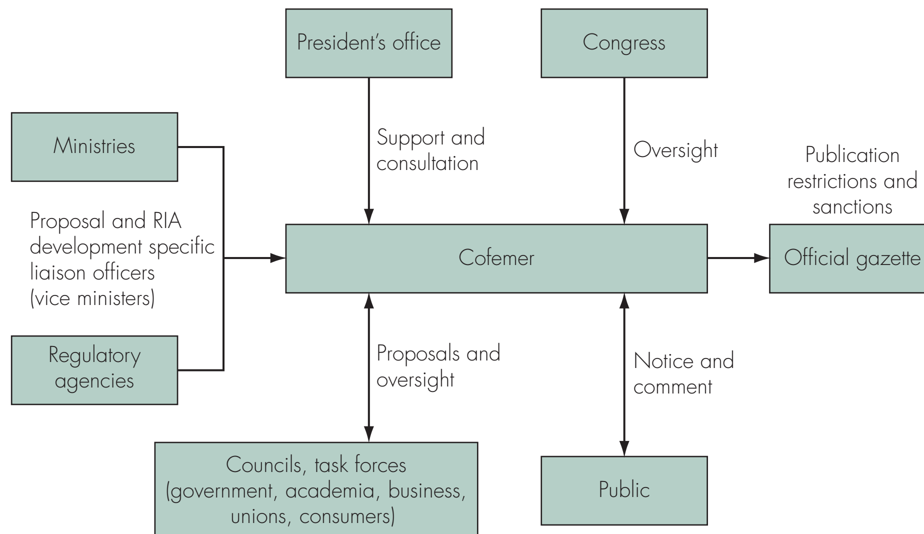
Unlike other independent commissions, Cofemer was created not to regulate private sector activity but to impose quality and transparency disciplines on the public sector. It was set up with a clear legal mandate to ensure the transparency of the regulatory process—for example, by ensuring public access to information on existing regulations and to key regulatory proposals before their entry into force—and to promote regulations offering the greatest net benefit to society (Figure 2). Cofemer quickly became a driving force for regulatory reform in Mexico.

Changes in the Federal Administrative Procedures Law were designed to ensure a minimum standard of regulatory reform within the government even in the event of a change in administration. The reformed law specified the components of the regulatory reform program—deregulation of formalities, transparent review and development of regulatory proposals, and assistance to state and municipal governments. And it required that each federal ministry and decentralized agency (such as Pemex and the Mexican Social Security Institute) designate vice ministers in charge of regulatory reform and biennial regulatory reform programs.

5 The proposal was presented to Congress, where it was approved without a single opposing vote, proving that regulatory reform was an ideologically neutral policy and one of the few matters on which the Congress elected in 1997 (the first in which no party had an absolute majority) could unanimously agree.

FIGURE 2

## Architecture and Management of Regulatory Reform in Mexico




*Note:* RIA is regulatory impact assessment.

In addition, the law expanded and consolidated the Federal Registry of Business Formalities—now the Federal Registry of Formalities and Services. Today the law requires federal ministries to include all their formalities for businesses and individuals in the registry—and permits only those listed to be officially required. This gives businesses and individuals greater certainty about their rights and obligations.[6]

6. The registry has since been enhanced with search tools, downloadable forms, and online assistance and other e-government tools.

# 4. REFORM PROCESS AND INSTITUTIONAL DESIGN

The process and institutional structure for Mexico's reform program in 1988–2000 reflected a top-down approach aimed at expeditiously pushing through reforms. Over time, the government increasingly institutionalized the processes of reform. In response to changes in the political environment, it also broadened consultation.

## Government Leadership and Strategy

The reform in Mexico was undertaken under the direct guidance and supervision of the president along with a tight group of reformers at lower levels. During the Salinas administration (1988–94), a cohesive and determined circle of technocrats pushed for the retrenchment of the public sector through highly visible privatizations and the negotiation of NAFTA.

The strategy Mexico's reformers followed was a loose approach of linking initiatives to improvements in market conditions internally and externally. The reformers acted opportunistically, looking for political openings and using commitments under NAFTA and the World Trade Organization as a central justification. They often adapted international practices, and they made good use of international advice, including from the World Bank and the OECD.

Accustomed to a centralized power structure, Mexican society broadly accepted the top-down approach based on traditional command-and-control mechanisms. Although key privatizations had detractors, the new economic strategy was well received, particularly by the private sector. Market openness measures were perceived as a sign of the administration's commitment to reducing the government's direct role in the economy. And in the end, the president was powerful enough to silence influential political and intellectual circles suspicious of bilateral relationships with the United States.

The top-down strategy, aimed at achieving fast and visible results, was successful in reaching its short-term goals. But medium-term, broad-based results were slower to materialize because of the macroeconomic crisis of 1994**.** What would have happened without the crisis is hard to imagine, because more of the privatized firms might have survived. But some initiatives, particularly key

privatizations, clearly had basic shortcomings in design. As a result, there was a huge backlash against "neoliberal" reforms.

Consequently, the Zedillo administration (1994–2000) was forced to follow a more cautious and measured approach, focusing on regulatory institutions and laws to promote a more open regulatory environment. In the spring of 1995, for example, the government organized a series of events across the country to foster broad consultation in preparing the 1994–2000 National Development Plan. Having learned from past mistakes, the presidential team adopted a more participative approach in pushing for further bilateral and multilateral market openness initiatives and structural reforms—especially in the sale of the few remaining state firms, which were more politically sensitive privatizations.[7]

The new administration also began to focus on building a long-lasting constituency for reform, particularly among small and medium-size enterprises, which had been neglected in the earlier reforms. Its emphasis on reducing the formalities to open a business, and drastically reducing the excessive discretion that was fostering corruption at front desks and during inspections, was part of this.

In addition, the new administration accelerated the institutionalization of reform bodies, transferring many regulatory functions of sectoral ministries to autonomous and semiautonomous agencies in hopes of dealing more efficiently with the regulatory problems that had surfaced following imperfect privatizations, particularly in infrastructure (Box 2). Another purpose, achieved with less success, was to try to isolate important regulatory functions from the political process.

The political landscape changed significantly as a result of the 1997 midterm elections, when none of the three main political parties won a majority of seats in Congress. And as Mexico became more democratic, the top-down model was reaching its limits. Congress and the judiciary were starting to block many reform initiatives, and a general backlash against reforms started to brew. Partisan politics, exacerbated by the unilateral presidential strategy for the reforms of the preceding decade, severely limited the reform agenda from 1997 to 2000.[8] While most of the earlier reforms had been designed without involving the other branches of government, the new political environment forced the executive branch to better communicate and build stronger consensus for reforms. The new checks and balances also helped in imposing higher-quality regulatory disciplines and transparency on the executive branch, as evidenced by the approval of reforms in administrative procedures.

## Institutional Arrangements

Part of the justification for following a top-down approach was the Mexican government's huge bureaucracy; undertrained, politicized, and demoralized, it could not be changed quickly. To respond to the quickly evolving international situation and the expectations of society, the government made a pragmatic decision to spearhead reforms without involving the public administration. The lack of a civil service in Mexico helped by making it easy to carry out a radical, focused replacement of not only ministers and vice ministers but also directors general and other mid-level public servants in key areas.[9]

7 Importantly, the market openness pillar was not downplayed. The close relationship with the United States cultivated through NAFTA turned out to be an important factor in the rapid recovery from the crisis: access to its key export market was secure (indeed, enhanced because of the devaluation of the peso), and the United States played a central role in the International Monetary Fund plan to secure Mexico's short-term liquidity during 1995.

8 For example, the National Action Party (PAN) voted against the Zedillo electricity reform for partisan political reasons. A similar reform presented by President Fox (PAN) early in his administration would also fail to pass in Congress.

9 Until 2002, Mexico had no civil service except in the Foreign Affairs Ministry and the Bank of Mexico. This created instability among technocrats and a short-termism in the design of reforms.

BOX 2

## Developing a New Breed of Market-Based Institutions

Independent of the emergence of the regulatory policy, as Mexico embraced market-based policies the government decided to develop institutions that could manage and regulate more efficiently than the traditional bureaucracy. These new entities have three characteristics in common: they have a high degree of technical specialization; they concentrate on regulatory or enforcement issues, leaving policy matters to the ministries; and they have greater autonomy, particularly in human resource policies.

But the new institutions also differ from one another. On the basis of their legal autonomy relative to the executive branch, for example, these entities can be divided into four broad categories (the dates are those of the most recent reforms):

- *Independent from the executive branch*—the Bank of Mexico (since 1994) and the Electoral Institution (since 1996).
- *Independent within the executive branch*—the National Commission for Human Rights (since 1992), the Federal Competition Commission (since 1994), and the Federal Institute for Access to Information (since 2002).
- *Policy setting, partially autonomous, and technically independent*—the Energy Regulatory Commission (since 1995) and the Federal Regulatory Improvement Commission (Cofemer, established in 2000).
- *Technically autonomous from the sectoral ministry*—the Federal Telecommunications Commission (Cofetel, established in 1996), the National Banking and Securities Commission (CNBV, established in 1995), the International Trade Practices Unit (established in 1991 as the General Bureau of International Trade Practices and renamed in 1993), the National Institute of Ecology (established in 1996), the National Water Commission (Conagua, established in 1989), and the Revenue Administration Service (established in 1997).

*Source:* López Ayllón 1997.

Thus, personnel in offices close to the "nucleus" of reform were almost completely replaced. A new layer of reformers was imposed on top of the traditional bureaucracy, which was largely unaffected by and uninvolved in the reforms. That permitted a rapid start to legal reforms that later bogged down as implementation got under way.

In the first phase, the government created special units in charge of the three main pillars of structural reform—trade liberalization (Office for the Negotiation of NAFTA), privatization – Unit for the Divestiture of Parastate Entities (UDEP), and regulatory reform – Economic Deregulation Unit (UDE). The institutional architecture in these new areas basically followed the same plan: a flat structure staffed by a couple of dozen technocrats recruited from top academic circles.[10] Fundamental processes of government were not altered, nor was there any effort to institutionalize change through a coherent human resource policy.

As the new strategy of regulatory governance emerged, however, it became clear that greater effort in implementation would be needed to sustain the deep changes in economic and regulatory orientation. By 1995, the UDE was playing a pivotal role in managing the regulatory system and advocating further reforms. This key role

10 Interestingly, this pool of technocrats existed thanks to key reforms in the scholarship system in the early 1980s. Since these reforms the federal scholarship agency (the National Science and Technology Council, or CONACyT) automatically awards generous scholarships to any students accepted for postgraduate study by any university on an official list of the most prestigious in their field. Strangely, fewer students in law than in economics have taken this opportunity.

received confirmation from Congress when it approved the proposal to transform the UDE into the stronger and more independent Cofemer.

Another central player was the Federal Competition Commission (CFC), established in 1993. As the new competition authority gained confidence, it created a powerful alliance with the UDE and then Cofemer in advocating market-based reforms. The authority played an important part in liberalizing a market traditionally dominated by a narrow set of economic interests by investigating and preventing anticompetitive mergers and monopolistic practices. But despite its enhanced autonomy, it lacked the political power to contest major ministerial decisions and to coordinate with sectoral regulators. Its effectiveness was also constrained by the courts, which did not always support its decisions.

Another set of players was the new breed of regulatory institutions that began to emerge in the mid-1990s following the privatization drive. The performance of these institutions has unfortunately been mixed.

## The Role of the Public Service

For most of the reform period the bureaucracy was treated as either irrelevant or hostile. This was possible in Mexico because the bureaucracy is quite weak at the policy levels—indeed, the entire policy layer of the public administration serves at the pleasure of the president and is usually replaced when a new one takes office. So it is easy to put into place policy officials who enthusiastically support the president's policies, but last only a short time. Lower levels of the administration have few policy functions and were not involved in the policy reforms. Though heavily unionized, public employees outside the state-owned enterprises traditionally have been politically weak.

Still, significant efforts were made to build a sustained, reform-minded public service within the administration—as represented by the creation of the Vice Ministry for International Trade Negotiations and the Federal Competition Commission in 1993 and the expansion of the UDE (both in size and in responsibilities) in 1995 and its transformation into Cofemer in 2000. But these efforts touched only the highest levels of the administration while the rest continued its glacial course, unimpeded by the furor at the top.

In retrospect, the failure to undertake a more thorough reform of the public administration earlier, and to sustain efforts to reform the administrative machinery and bureaucracy, created a big obstacle to implementing many reforms. The lower levels of the public service never had a sense of ownership—possibly one factor in the public sentiment against reforms after 2000.

## Legal Process

The restructuring of the Mexican economy from the mid-1980s to the mid-1990s was based on an almost complete overhaul of the legal system. While the sequencing of reforms did not necessarily conform to a well-coordinated plan, two major legal pillars anchored the fundamental transformation in market structure and regulatory policy: NAFTA and the Federal Administrative Procedures Law.

### NAFTA as an Anchor for Reform

The NAFTA framework was instrumental in Mexico's transition to a more stable regulatory framework, based on the rule of law, in which administrative discretion (such as over private property rights) was curtailed unless absolutely necessary. Moreover, as an international treaty that takes precedence over federal laws in Mexico, NAFTA reduced the discretion of law makers and rule makers to reverse the reforms. This was crucial to safeguard against the capture of Congress by special interests, the biggest threat to the reforms in Mexico.[11]

11 This capture is made easier by electoral laws that prohibit reelection and are based on a strong proportionality system, which reduces the political accountability of members of Congress. Moreover, dominated by a single party until 1997, Congress could easily amend the Constitution.

NAFTA also provided an important boost for regulatory reform through its effects on competition—as it became increasingly apparent that the costs of doing business would have to be sharply reduced for Mexican firms to compete in the North American market. The argument that Mexico needed to change so as to adapt successfully to the new economic conditions created by NAFTA, and the irreversibility of the process, helped drive deregulation and the reforms to sectoral regulatory frameworks (such as those for mines, railroads, telecommunications, and gas distribution).

Even in the wake of the deep economic crisis in 1994–1995—when calls for renegotiating NAFTA were widespread—the balance was tilted in favor of accelerated reform. One reason was the legal stability of the treaty. Another was that it had created an important constituency for reform: exporters whose contribution to economic growth and job creation would be one of the main reasons that the crisis was relatively short-lived.

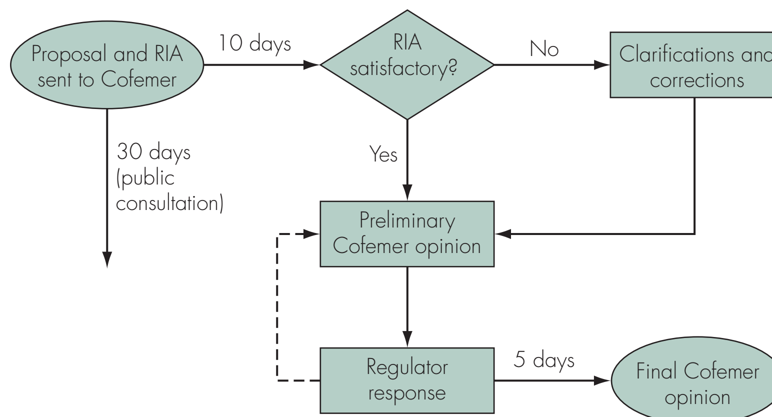
NAFTA's requirements for transparency and public comment were also precursors to significant changes in the federal regulatory process. In 1992, the Federal Metrology and Standards Law was enacted to guarantee transparency and opportunity for public comment in the development of technical standards. This was done in part to show that changes in nontariff barriers would be made in a predictable and transparent way—a central concern for Mexico's negotiating partners for NAFTA. In 1995 the Agreement for the Deregulation of Business Activity created the first government-wide regulatory review program (see the following section). NAFTA also fostered a major reform of customs and inspections systems (see FIAS 2004).

### Administrative Procedures Law as a Second Anchor

A parallel pillar—and vehicle—for reform in Mexico was the Federal Administrative Procedures Law (enacted in 1994 and amended in 1996 and 2000). This law created a firm basis for all interactions between the government and private citizens by setting out rules for requesting information, issuing resolutions, undertaking inspections, and respecting due process. The 1996 amendment of the law first established the obligation for carrying out regulatory impact analysis. This reinforced the UDE's authority to require clear justification for Regulatory proposals and led to the government-wide program of regulatory impact analysis based on a common methodology and independent review (Figure 3).

FIGURE 3

Mexican Process of Regulatory Impact Analysis Since 2000




*Source:* www.cofemer.gob.mx

*Note:* RIA is regulatory impact assessment.

This 1996 amendment, combined with the Agreement for the Deregulation of Business Activity, represented a major shift in the regulatory process. For the first time regulations across a range of issues—from infrastructure to health and the environment—were challenged by criteria of regulatory quality. The burden of proof on the desirability of any regulation was shifted to the sectoral ministries.

The requirements for transparency and regulatory impact analysis introduced a new mechanism of checks and balances and a filter for potential errors and abuses. Among the most important innovations of this process were the following:

- Assigning responsibility for regulatory impact assessments to a vice minister in charge of regulatory reform in each ministry or decentralized agency,
- Requiring such officials to present two-year regulatory improvement programs to Cofemer and for public comment,
- Requiring that all regulatory impact assessments, proposals, and opinions by Cofemer be made public,
- Requiring that regulatory proposals be sent to Cofemer at least 30 working days before their enactment or before being sent to the executive's chief legal counsel for signature by the president.

The transparency and public comment procedures were enhanced by Cofemer's use of the Internet. Cofemer's Web page contains the entire Federal Registry of Formalities and Services and all regulatory proposals under review, including full draft texts and regulatory impact assessments. Anyone may send comments to Cofemer, which is legally obligated to consider all public comments before issuing its opinion.

All this represented an enormous change in the conduct and perception of the federal public administration in Mexico. Regulatory changes could no longer be secretively drafted and suddenly published in the official gazette *(Diario Oficial de la Federación)*. The result has been much greater legal certainty for businesses and individuals and a strong incentive to participate in the review process. Many newspapers, academics, and business associations now regularly review Cofemer's Web page to see what regulatory projects the government is working on.

The transparency of the process provides a strong incentive to prepare sound regulatory impact assessments, assuring Cofemer and the public of high-quality information for their review of the proposals. Further support for quality comes from a training program and an online system to facilitate the preparation of regulatory impact assessments.

The new process has proved to be leaky, with pressures, political motives, and perceptions of urgency for particular regulations in some cases leading to circumvention of the controls. But the mechanism of regulatory impact analysis and consultation has raised the cost of pushing low-quality regulation, and acceptance of the new procedure is growing.

Cofemer has continued to push for further disciplines in transparency and consultation. In 2002, it designed a groundbreaking access to information law that created the Federal Institute for Access to Information, with substantial autonomy. This has been a major step in aligning government processes with the growing calls for transparency and accountability in a nation that is consolidating its democratic values.

## Management of Stakeholders

During most of the reform period the executive was able to drive reforms with little participation by stakeholders except for those at the highest levels. Yet the program and policies were well received by business and other social groups—and even by Congress, still dominated

by one party. Through an ad hoc approach, the government was able to manage reform and find compromises to move forward.

#### Consultation with Stakeholders

There were rumblings below the surface, however. The business community's alienation and distrust resulting from the nationalization of the banking system in 1982 took about eight years to overcome. It was not until the privatization of banks and the negotiation of NAFTA that true collaboration began to reemerge between the private sector and the government. President Salinas's strategy for regaining and maintaining the trust of the private sector was to closely involve it in the policy choices made. This was done through a solidarity pact that also included government-endorsed union leaders.

A corporatist-style framework of consultation and policy discussion involving business and union leaders was created for each of the three pillars of structural reform. The most developed example was the Economic Deregulation Council, bringing together representatives of government, business, labor, and academia. The weakest related to the privatization program. Beyond the Bank Divestment Committee, the government preferred to negotiate the privatization strategy directly with the unions.

With some exceptions, these consultation bodies were narrow and had difficulty in reaching out to broader society. The absence of consumer interest groups, insufficiently developed in Mexico, was conspicuous.

After 1994 the government started to change tactics, sharpening its focus on building trust and constituencies. The advisory bodies were reformed. A typical example relates to the creation of Cofemer in 2000. Its advisory council was expanded to include key public sector institutions (the Federal Competition Commission, the president's legal counsel, and the Consumer Protection Agency, or Profeco). That helped build a wider pro-reform group in the government and advance the process of regulatory reform. The advisory council turned into a dispute resolution forum for discussing contentious issues, ensuring the accountability of the UDE and Cofemer, and pressuring laggard ministries to implement the government-wide reform strategy.

After the 1997 midterm elections, when Congress became an independent interlocutor, negotiating with a broader set of constituencies and stakeholders became vital and more complicated. Even then, however, important reforms were enacted, particularly administrative and regulatory improvements. One example is the historic reforms to the Federal Administrative Procedures Law in 2000, unanimously approved by Congress. This success might suggest that reforms to procedures, where there are no clear winners and losers, are easier to pursue than reforms to substantive economic policies.

#### Compensation for Losers

In trade liberalization and privatization, by contrast, a clear pattern of winners and losers appeared. NAFTA required big adjustments by the business community to survive in the more competitive environment, creating resistance to market opening. But Mexico's reliance on export growth and foreign investment to emerge from the 1982 and 1987 crises had created a business constituency for continued market opening. The fact that exports generated the biggest share of GDP growth after the 1994 crisis also helped cement the policy of market openness. In short, many interests had already emerged around market opening, and these interests were sufficient to give the president the support needed to maintain reform.

Compensating the losers was a clear concern from the beginning. Adjustment programs were set up to manage the transition costs in urban and rural areas and to compensate some of the losers from trade liberalization. These programs included the National Committee for Productivity and Technological Innovation (Compite) for small

and medium-size enterprises, Pronasol (Solidarity) for the poor, and Procampo for rural areas.[12]

Many of the most interesting cases of managing interest groups during the reform process relate to privatizations. According to some observers, the fact that only Mexican nationals were allowed to participate in the privatization of banks was an implicit bargain struck in exchange for the general business sector's support of NAFTA. This agreement made business leaders partners in the economic policy process.

Reforming public services—with or without privatization—often requires compensating existing workers and paying the costs of transition to the new system. In practice, the general benefits of reform far exceed these costs and thus justify "buying" the support of well-organized, vocal, and powerful interests, most of them either part of the bureaucracy or heavily unionized. In Mexico, the government resolved to secure union backing in some cases by offering generous financial help through funds provided by Nafin, a government development bank.

In telecommunications, an explicit guarantee of continued employment was a major part of the negotiation package. The deal also included subsidized loans to employees for the purchase of slightly more than 4 percent of Telmex's stock and limits on foreign ownership. A creative reorganization of the voting rights associated with Telmex's shares allowed the participation of foreign capital while making it possible for a domestic group to exert control with just over 20 percent of total shares.

In the railroad sector no such guarantees could be made, because all evidence pointed to excessive employment. Here the government's strategy was to relieve private firms of labor burdens by privatizing only after a labor restructuring that involved paying workers more than they were entitled to by law. This approach was costlier. But by liberating private companies from "social burdens," it also made it much easier to impose pro-competitive market regulations—because enterprises no longer had a strong bargaining chip for use in lobbying.

The cost of restructuring before the privatization of state enterprises turned out to be greater than the government proceeds from the sale. But the long-run efficiency gains—derived from a more competitive market structure and regulation—probably outweigh the short-term burden of compensating losers. Even so, this strategy inevitably had an adverse short-term impact on public finances. That made marketing the reforms more difficult, because there were no short-term gains for the public from privatization (unlike in the privatizations of the early 1990s, which balanced public finances).

The reemergence of strong opposition to reform at the end of the 1990s and a virulent backlash against market-based approaches since 2000 suggest that the efforts to broaden communication and consultation were not able to reach deeply enough into society. Members of a more combative and multiparty Congress, for example, increasingly questioned the reforms.

## Resource Issues

The Mexican reforms were achieved through a combination of strong political will and a small but powerful team of reform-minded technocrats. As a result, the reforms involved relatively limited administrative and fiscal resources except in the case of some privatizations. Indeed, Mexico seems to have invested too little in building the new skills and attitudes needed in the public administration to sustain the reforms.

The new offices in charge of trade negotiations, privatization, and economic deregulation were financed mainly by redirecting existing public

12 Compite provided funds for consulting and training activities, up to 70 percent of the cost or a maximum of around $5,000 per firm (according to the most recent data, for 2003). Spending by Pronasol represented 1.2 percent of GDP between 1989 and 1994. And Procampo accounted for 6.5 percent of the government budget in 1995.

funds and administrative structures. The Office for the Negotiation of NAFTA and the Unit for the Divestiture of Parastate Entities (UDEP) were staffed by about 40–60 people. The UDE initially had an annual budget of $1 million and a staff of about 15, expanding to $5 million and about 60 professionals by the time Cofemer was created. This structure is still relatively small in the light of Cofemer's important government-wide tasks, however.

While the budgetary cost of creating and maintaining the new regulatory reform agencies is low, their existence and operation have continued to fuel discussions. Some observers have speculated, for example, that merging Cofemer and the Federal Competition Commission and consolidating financial and sectoral regulators may be more efficient, as it would make the best use of scarce regulatory talent and public sector financial resources.

The long-run viability of a wide-ranging reform program seems to justify significantly greater investments in reengineering the public administration, training personnel, and raising the general salary level of the public servants in charge of the machinery and management of reform.[13]

13 The administration of President Vicente Fox tried to solve this problem in part by considerably increasing the salaries of senior public servants. But this may have widened the salary gap between senior and mid-level public servants (the salary ratio between directors general and directors is up to 3 to 1).

# 5. IMPACT OF THE REFORMS

The reforms to transform the role of the state in Mexico's economy appear to have led to positive economic developments. A thriving private sector has emerged in Mexico, and exports have seen tremendous growth. The reforms have also transformed the regulatory environment, instilling a market-oriented culture of transparency and accountability. Recent developments in the political environment, however, have made sustaining the reforms more difficult.

## General Economic Performance

The regulatory reform in Mexico is generally agreed to be directly linked to positive developments for the Mexican economy. But a few words of caution are in order. First, the 1994 currency crisis, which led to a contraction in GDP of more than 6 percent—wiped out many early benefits of reforms. It also drove many newly privatized (and therefore inexperienced) firms into bankruptcy, particularly in the financial, construction, highway, and airline sectors (though corporate fraud and scandals also played a part).

Second, evaluation of policy and reforms was rare in Mexico during the 1990s. Part of the reason was that this task would have required diverting resources from policy design and implementation; in the context of cost reductions, devoting specific resources to such tasks was indeed difficult to justify. Moreover, executive agencies became worried about how the results of evaluation would be accepted: If they were too negative, there was a risk of fueling the opposition to reforms. And if they were too positive, a skeptical public might view them as self-promoting propaganda.

For these reasons, care should be taken in interpreting the results of the reforms. Moreover, drawing direct links between microeconomic reforms and macroeconomic outcomes is always difficult.

### Emergence of a Thriving Private Sector

Although the regulatory reforms were only part of a larger picture, the response of the private sector to the changing environment was rapid and robust. The private sector share of GDP reached nearly 90 percent by the end of the

1990s, up from around 60 percent in 1980. Prices in fully deregulated sectors such as port services, trucking, and intercity transport fell substantially. And productivity rose in regulated sectors such as gas and mining (OECD 1999).

### Huge Gains in Exports

Between 1983 and 2000, as Mexico transformed itself from a very closed economy to one of the most open in the world, its exports rose dramatically. Nonoil exports jumped from $12 billion to $150 billion, and trade grew from 26 percent of GDP to 64 percent. Indeed, Mexico became the eighth biggest exporter in the world.[14]

Along with the growth in trade came a big increase in private capital inflows and foreign direct investment, though per capita gains were less impressive (Figure 4). Between 1980 and 1999, net capital inflows to Mexico were equivalent to 3.3 percent of GDP on average (rising to 4.3 percent after 1989). Capital inflows rose dramatically in the years following the banking privatization and in expectation of the conclusion of the NAFTA negotiations. Mexico became a key player in many sectors, and some of its major firms started to expand abroad.

14 This ranking counts the European Union as one entity (Germany, France, the United Kingdom, the Netherlands, Italy, and Belgium all have higher total exports than Mexico).

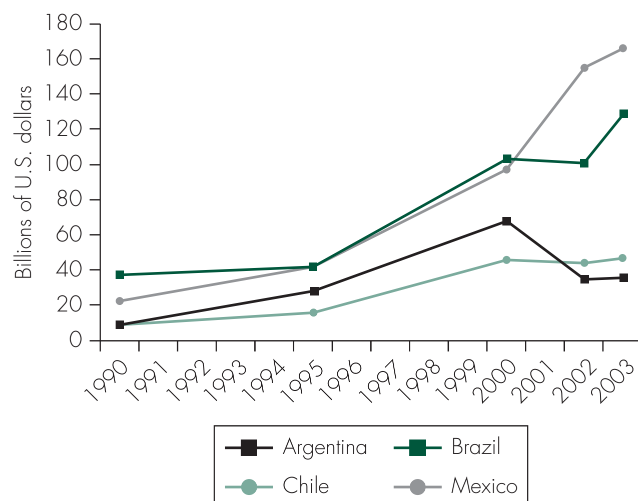
The increased flexibility of the economy, linked to the extraordinary growth of exports and driven by NAFTA, was clearly evidenced by the prompt recovery from the 1994–95 economic crisis. After the 1982 crisis, it took Mexico more than eight years to return to international capital markets; after the 1994 crisis, it took only one year. As the OECD has emphasized, regulatory reform can play an important part in increasing economic flexibility and reducing the length and depth of economic downturns.

## Specific Impacts

Thanks to the reform efforts of the period under review (1988–2000), Mexico developed a more modern, market-based regulatory infrastructure

FIGURE 4

Stock of Inward Foreign Direct Investment, 1990–2003




*Source:* UNCTAD 2004.

than its major competitors in Latin America. The result is not only an enhanced domestic regulatory environment but also greater capacity to integrate with the world economy.

### A Market-Oriented Regulatory Culture

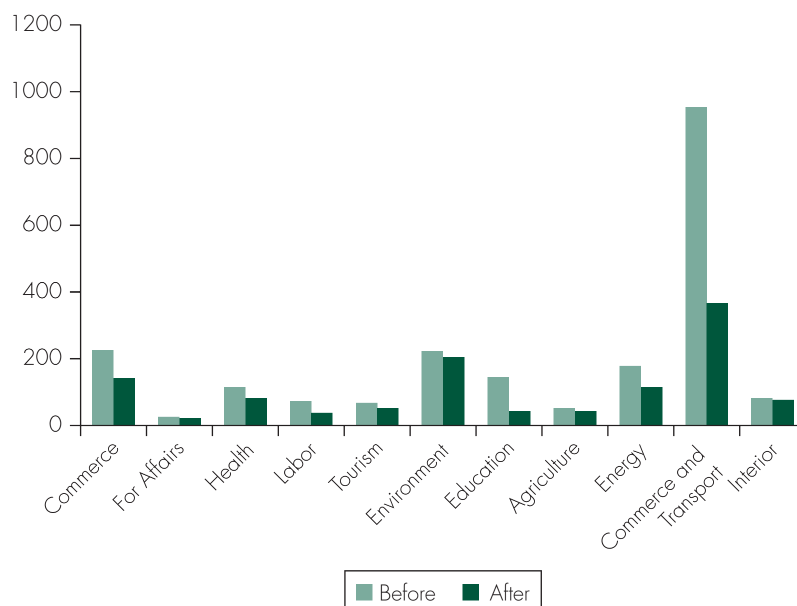
Regulatory reform played an integral part in Mexico's rapid transformation into an open-market economy. The privatization of thousands of state enterprises and the liberalization of trade—including through joining the GATT and signing NAFTA—required a massive readjustment of its regulatory framework. Indeed, Mexico modified an estimated 90 percent of its regulatory framework—the legacy of some six decades of legal work (López Ayllón 1997).

The first targets were the economic regulations that interfered with market decisions on pricing and entry. Beginning in 1989, the government deregulated entry, exit, and pricing in virtually all tradable goods and services sectors (see Appendix 2). It removed all price controls—including on tortillas (1992–99). And it promulgated or reformed important framework laws: technical standards (1992), competition (1993), foreign investment (1993, 1996), civil and commercial judicial procedures (1996), bankruptcy (2000), credit guarantees (2000), and e-commerce and public registries of property (2000). The government also greatly simplified the administrative requirements for the establishment and operation of firms. In 1995–2000, working together, the UDE and federal ministries reduced the number of business formalities from 2,038 to 1,103 and simplified or improved 97 percent of the remaining ones—such as by shortening response times, eliminating requirements for data or documents, or establishing "silence is consent" rules (Figure 5).

As part of the regulatory review process, the UDE reviewed more than 500 regulatory proposals in 1995–2000. According to a study by Cofemer in 2000, regulatory impact analysis proved to be an effective tool for identifying inadequate regulatory proposals and preventing their publication as official regulations. While

FIGURE 5

Reduction in Licenses, Permits, and Other Information Requirements by Mexican Ministries, 1995–2000




*Source:* UDE 2001.

85 percent of draft regulations sent to the UDE that did not require regulatory impact analysis (because they involved no compliance costs for citizens) were eventually published in the official gazette, only 60 percent of proposals requiring such analysis were published.

This does not necessarily mean that the regulations were abandoned, but it does suggest a substantial reworking of the proposals. These data coincide with numbers in Cofemer's yearly reports showing that about 20–30 percent of proposals received are subject to detailed scrutiny (which involves requesting corrections to the regulatory impact assessment or detailed suggestions or comments on regulatory content).

Reforms reached beyond the federal level. The UDE helped state and municipal governments in drafting important regulatory laws relating to water and the securitization of mortgages. It also assisted in creating online registries of formalities and implementing programs to make business start-up easier.

These efforts would eventually lead to the creation of the Rapid Business Start-Up (SARE) system, which by June 2008 was operating in 134 municipalities with high levels of economic activity. This system allows low-risk businesses to open in 2 working days, compared with the national average in 2001 of 57 days.[15] Results have been uneven, however. This is particularly so in Mexico City, where a new administration campaigned on an antibusiness platform, promising to reverse earlier reforms and federal initiatives.

Governance indicators published by the World Bank point to high marks in regulatory quality for Mexico from 1996 to 2000—and to substantial improvement in government effectiveness, rule of law, and control of corruption (Table 1). Ultimately, the most significant reform may have been the creation of the regulatory review process, based in law and aimed at avoiding unnecessary costs for businesses and individuals. This process has entailed a profound change in the way the government operates, favoring predictability, transparency, analysis, and public consultation.

15 Much of the improvement has not been clearly reported by the World Bank Group's Doing Business exercise in its national ranking for Mexico, which reflects a large number of days required to open a business. The ranking may be skewed by the fact that it is based on practice in Mexico City, which has not yet adopted the innovative Rapid Business Start-Up system.

TABLE 1

## Mexico's Percentile Rank on Major Governance Indicators, Selected Years, 1996–2002

| Indicator | 1996 | 1998 | 2000 | 2002 |
|---|---|---|---|---|
| Voice and accountability | 42.9 | 45.0 | 55.0 | 59.6 |
| Political stability | 34.8 | 24.8 | 45.5 | 50.8 |
| Government effectiveness | 52.0 | 69.4 | 69.6 | 61.9 |
| Regulatory quality | 74.0 | 75.5 | 76.2 | 68.0 |
| Rule of law | 55.4 | 40.5 | 45.9 | 52.1 |
| Control of corruption | 39.3 | 41.0 | 44.0 | 52.1 |

*Source:* Kaufmann, Kraay, and Mastruzzi 2003.

*Note:* Percentile rank indicates the percentage of countries worldwide that rate below Mexico.

Regulatory policy also contributed to the modernization of the institutional design of crucial regulatory agencies. Cofemer and the Federal Competition Commission now play central roles in promoting transparency and economic efficiency within the federal government and in specific economic sectors. These institutions have been joined by the Federal Institute for Access to Information, the regulator responsible for ensuring public access to nonclassified government information.

## Sustainability

Despite these gains, the reform agenda is incomplete—and the sustainability of the process unclear. As a result of the changes to the Federal Administrative Procedures Law in 2000, Cofemer and the regulatory reform process have continued to contribute to the setting of public policy priorities. Compliance with regulatory quality criteria has improved as the culture of regulatory impact analysis becomes increasingly embedded in the normal process of developing regulations. The number of proposals for review has increased dramatically, reflecting greater compliance with the regulatory review process.[16]

The administration of President Vicente Fox (2000–06) increased Cofemer's budget and personnel by around 50 percent in 2001, even in the midst of a net reduction of both in the rest of the government. Other important developments also have occurred. These include congressional approval of the federal freedom of information law, a presidential decree to accelerate improvement of the Federal Registry of Formalities and Services and reduce the number of formalities by another 20 percent, a rapid increase in the number of cities participating in the Rapid Business Start-Up program, and a moratorium on new regulations in April 2004.

16 In 1999, the UDE received 143 proposals with regulatory impact assessments; in 2003, Cofemer received 408.

Nevertheless, some observers perceive a greater risk of regulatory capture in some areas of the government, leading to more friction in the regulatory review process with Cofemer, less success by Cofemer in fighting bad regulation, and less efficient regulatory results. Worse, the reform process has stalled at the legislative level because of partisan divisions in Congress. As a result, the Fox administration focused its regulatory improvement efforts on the executive branch.

Moreover, Mexico has not been successful in launching new structural and regulatory reforms or in implementing and enforcing many already enacted. Structural reforms in such key sectors as water and energy have either not started or, if started, have not been implemented or deepened. The lack of competition in many sectors, particularly infrastructure, has led to persistently high operating costs for businesses. Mexican labor laws are still considered very restrictive. Successive administrations have been unable to implement modern fiscal reforms. And significant problems persist in contract enforcement.

Context is important for sustainability. Privatization was a fiscal success, partially meeting many of the government's goals—including strengthening public finances, eliminating socially or economically unjustified spending and subsidies, promoting economic productivity, and improving the efficiency of the public sector by reducing its size (Rogozinski 1993, 41). But privatization undermined the sustainability of the wider regulatory reforms. The privatization fiascos that occurred after the 1994 financial crisis reduced the benefits of market reforms and elevated public distrust in reform. By 1995, the government was obliged to intervene and directly or indirectly renationalized most of the "too big to fail" banks, highways, and airlines.

More important, the political economy of reform changed rapidly in the mid-1990s, making further progress extremely difficult. Achieving buy-in across all ministries to the democratization and transparency embedded in new

approaches required more discussion and negotiation, and the Zedillo administration also had great difficulties in fighting the populist rhetoric that grew after the 1994–95 crisis.

The peso crisis—and the cronyism and corruption that it uncovered—helped vocal special interest groups and supporters of the *ancien régime* equate deregulation and market-based solutions with chaos and profiteering. The electoral laws and political dynamics foster a Congress divided into three similar parties motivated by unstable alliances to act strategically. The opening of political arenas helped nationalistic interests oppose any major new reforms, first at the street level, then in federal and state congresses. Interest groups representing employers rapidly joined these movements, demanding less competition and more protection.

In the face of these pressures, the top-down technocratic apparatus was incapable of effectively communicating the rationale for further reforms and clearly articulating their costs and benefits.

# 6. LESSONS OF THE REFORMS

Mexico's reforms in 1988–2000 represented a radical shift in its economic orientation—away from an inward-looking, interventionist economic model toward an export-oriented, market-based one—a shift remarkable by international standards. The Fox administration pursued the same orientation, though with less success because of lack of support from Congress for further privatizations and structural reforms. By 2000 reform fatigue had set in, coupled with a more dynamic political environment in which losers in earlier reforms had gained more voice. From the perspective of today, the reform period looks like the rise and stagnation of a technocratic reform model.

The changed political environment makes it doubtful that Mexico today could replicate its reform strategies of 1988–2000. But this "long decade" of experiments and changes nevertheless points to lessons of general relevance. As the effects of the reforms continue to develop, however, the understanding and analysis of the experience may also continue to change.

## Success Factors

Mexico's reform strategies incorporated a range of factors that supported success in setting the reform agenda and in designing, implementing, and sustaining the reforms.

- *The reforms were guided by a comprehensive plan with mutually supportive elements.* The basic concepts of reform were designed around the pillars of market openness, privatization, and regulatory reform. These pillars were mutually supportive—market openness increased pressures for economic liberalization, which led to reforms in public sector capacities for good regulation. This logic sustained momentum as constituencies for reform were created—and helped push the next phase along. As the following section discusses, however, planning was insufficient, leading to problems in sequencing that undermined the benefits of reform.

- *High-level political support was translated into action.* The 1988–2000 reforms and

market-based policies received clear and sustained support at the highest levels of the federal government. This political support resulted in clear mandates, adequate resources for reform institutions, and the dedication of high-quality personnel in key ministries.

- *A top-down approach was used to trigger reforms.* The reforms were orchestrated in large part within the executive branch by a relatively small group of skilled reformers assembled by the president and placed in key government positions. Consequently, a surprisingly small pool of high-level economists contributed mightily to the reform processes.

- *The government used crisis as an opportunity to set the agenda for reform.* Both the Salinas and the Zedillo administrations made the best use of opportunities created by the financial crises they inherited. Although these crises underlined the difficulties of comprehensive economic reform in an interconnected world, the government used them to mobilize reform energies and push forward despite entrenched resistance.

- *The reforms were based in an explicit regulatory policy supported by trained professionals in a central reform body.* By the mid-1990s, a strong, coherent regulatory policy emerged as the basis for many of the concrete solutions that were adopted. The policy recognized that to function effectively, a market economy needs an accountable, transparent, and efficient regulatory framework. These principles have begun to take root in Mexico thanks to advances in communication technologies (such as the Internet) that make it easier to distribute and share information and compare performance—but also because of an important shift in the political and social system. In addition, setting up the UDE and Cofemer as the driving force for regulatory reform, and ensuring that they had the professional expertise needed, greatly improved the substantive quality of the reform strategies.

- *The reforms made effective use of international experience and best practices.* Mexico relied to some extent on its membership in the North American Free Trade Area and especially that in the OECD, which it joined in 1994, to learn about best practices in regulatory reform. And it was quick to adapt those practices to its own needs. Creating a central regulatory reform body, moving from deregulation to regulatory quality as the key principle of reform, and adopting regulatory impact analysis are all examples of good international practices that were of great value to Mexico.

- *High-level task forces delivered quick reforms and were able to overcome entrenched resistance.* To launch the reforms, the government created focused executive units in charge of cross-cutting policies. These units were needed to trigger changes, break administrative and cultural molds, and provide new capacities to the public administration. In all these cases, the strategy was to impose new structures on top of the bureaucracy—elite teams of high-level advisers with relatively little support staff. The heads of these units were allowed great discretion in staffing, a radical departure loosely based on the experience of private economic consultancy groups. The new entities were comparatively small but well resourced and had direct access to the highest levels of policy making. But the emphasis on efficiency and technical capacity in these units meant that there was little accountability and transparency, and the lack of effective checks and balances on their proposals allowed major errors. Their technocratic approach also prevented adequate outreach to other governance stakeholders: Congress, the judiciary, and the public administration. As reforms moved to the implementation phase, the government dismantled or institutionalized the units.

- *A mix of different mechanisms were used to compensate losers.* Dealing with interest groups opposed to reforms required a pragmatic mix of communication and education, institutional

alliances, compensation to aid adjustment in the short and long term, and the courageous exercise of leadership and power. Mexico relied on all these mechanisms. The costly labor restructuring undertaken before the sale of railroads was a key to its success. In the privatization of Telmex, reaching an acceptable agreement depended on a guarantee to retain workers combined with subsidized government loans to allow employees to purchase stock in the company. In the case of NAFTA, adjustment programs aided farmers and small businesses during the transition to a more competitive market environment. Mexico's experience also shows that when labor groups are included in the design of the restructuring process and the government is willing to assume the fiscal costs of reform, positive results can be achieved. The downside is that the government may forgo short-term benefits in the form of net income from the sale of state enterprises.

- *Links to international obligations such as NAFTA helped drive and anchor reforms, preventing backtracking.* NAFTA provided an institutional framework for reforms, establishing terms and obligations that could not be broken without incurring significant costs (much as the goal of accession to the European Union anchored the reform processes of countries of Eastern Europe). The treaty made reductions in tariffs virtually irreversible and established a supranational framework for dispute resolution to protect its array of disciplines. The credibility of the partners (the United States is Mexico's biggest export market) and the promise of economic benefits helped the government use the treaty to persuade and impose changes on interest groups that might otherwise have procrastinated and backtracked.

## Shortcomings

While many factors in Mexico's reform strategies supported success, there were also shortcomings that undermined the success and sustainability of the reforms in different ways.

- *The reforms suffered from inadequate sequencing.* The reforms pursued an overall objective of opening the economy and shifting the frontier between the public and private sectors, but had gaps in the strategy and monitoring mechanisms needed to sustain them over the long term. A particular weakness was the lack of sequencing of major reforms. The sense of urgency about restoring market credibility and attracting foreign investors placed added weight on quickly carrying out radical and politically visible reforms. Such was the case for the banking privatizations and the sale of Telmex. These privatization processes did not always reflected future governance arrangements that could have strengthened the development of economic sectors and included more competition.

- *Monitoring was neglected, leading to misperceptions and false expectations.* The lack of prior evaluation of costs and benefits permitted the overselling of reforms whose early benefits turned out to be disappointing. And the lack of systematic, ongoing evaluation led to an amnesia in which society and politicians forgot or minimized the benefits of reforms while emphasizing the costs, reducing support for long-term efforts.

- *Poorly developed competition and regulatory frameworks for privatized infrastructure services undermined support for the entire reform process.* A clear lesson is that as part of the liberalization process, markets must be properly regulated if consumers are to see the benefits of change. It is widely accepted today that a pro-competitive regulatory framework should be set up before the sale of utility monopolies—but Mexico did not do this, in part because of pressure from the World Bank for quick sales. Also accepted is that monopolies should be broken up or unbundled to increase competition and reduce the need for subsequent regulation. In key sectors Mexico did neither.

- *Short-term gains were not properly weighed against longer-term sustainability in some cases.*

Expecting that economic efficiency will be the only factor taken into account during structural reform is politically unrealistic. Yet the Mexican experience suggests that success depends on giving high priority to competition and economic efficiency. Designing regulatory or market structures before privatization (done in part for railroads) has been much more successful than attempting to regulate concession terms after the fact (such as in telecommunications), because these attempts can be blocked by legal challenges assembled by monopolies with "deep pockets." Setting regulatory and competition frameworks early on may reduce the government's income from the transaction, but it will ensure much more efficient services in the long run, enhancing national competitiveness.

- *The design of reforms often overlooked the different needs for their implementation.* The change orchestrated in Mexico was broad, ambitious, and carried out extremely quickly. But some legislative reforms never reached full implementation, and the speed of the reforms inevitably meant great difficulty in adequately assimilating the changes. Deep changes in regulatory approaches usually require long periods of gestation. These critical needs did not receive adequate attention during the design phase.

- *Lack of transparency and inadequate communication about the goals, benefits, and costs of reforms reduced their acceptance over the longer term.* In retrospect, earlier and stronger efforts were needed to institutionalize many of the reforms and communicate them to society. Speed and flexibility in policy making may be desirable for quickly pushing through necessary changes, but they are no substitute for transparency, dialogue, and inclusiveness in the reform process. In Mexico many reforms failed to achieve acceptance and ownership among large parts of society, particularly the public administration. This lack of consensus has led to an inherent instability in policy arrangements that ultimately undermines further, complementary reforms. The failure of some market-based reforms to gain the confidence of a large part of society has led some key stakeholders to shift from supporting the reforms to advocating their reversal.

- *Weaknesses in the quality of human resources and administrative processes, paramount in implementing reforms, slowed progress.* It is not enough to have institutions with well-designed missions and appropriate regulatory frameworks; it is also essential to continually strengthen these institutions with top-quality human resources. Regulators and enforcers must understand the reason for creating particular regulations as well as the ultimate goal of regulatory or administrative disciplines. The bureaucracy implementing the regulations needs to gain a sense of ownership and the impetus to act proactively. A major obstacle in the Mexican reforms was the difficulty in modernizing and depoliticizing the public administration (though a civil service law was approved in 2003).

- *Political and public support was too fragile to sustain the course.* A reform program to promote productivity and investment requires big administrative changes in terms of human resources and institutions and clearly defined goals subject to transparency and accountability. Political will to overcome bureaucratic resistance, fiscal resources to compensate those bearing the costs of change, and institutional design to ensure the continuity of policies are all key factors. But perhaps most important is building a wider consensus for change through efforts involving actors from the executive, legislative, and judicial branches of government as well as business, labor, and consumer groups. Mexico's difficulties in moving forward with further reform may suggest that the approach to setting the purpose and direction of change was too top down and autocratic, an approach that may compromise the continuity and coherence of reform.

## Lessons for Other Countries

Context, opportunities, external shocks, and changing environments will always frame the design and implementation of reform. Many of the lessons of Mexico's reform experience can be interpreted only through the political, administrative, and cultural context of that country. But five key lessons may prove to have broader applicability.

- *The depth of the political, social, and institutional reforms required to carry out structural change is linked to the overall acquiescence of society.*

The extent to which reforms are accepted and sustained depends on society's acquiescence. Without resistance, technocratic reforms can go fast and deep (as in Mexico at the end of the 1980s, Chile in the 1980s, or China and Vietnam in the 1990s). But if the technocrats lose trust for internal or external reasons (such as a crisis), top-down reform becomes harder and can even be counterproductive. A more consensus-based strategy is then required, and more time will be needed to communicate the strategy and build support. By the early 1990s the corporatist model was changing in Mexico, and reformers did not appreciate the shift. It took the 1994 economic and financial crisis for them to recognize the need for a more open and accountable approach. Beginning to establish the foundation for a new model of reform has taken many years.

- *As the reform process advances from launching to implementing change, involving different stakeholders along the way, political support needs to take different forms.*

Most studies reach the anodyne conclusion that political support is essential for radical reform. But the Mexican case study adds nuance to this, showing that political support must take different forms as the reform advances and involves different stakeholders. At the outset, political support for reform will mean pushing, commanding, and expending sheer political capital in overcoming resistance. Launching reform requires more sticks than carrots. But as reforms are adopted, laws enacted, and implementation begun, political support will mean providing guidance and steady leadership, ensuring more open and participative approaches, and defending the reform institutions that will be under fire. This difficult phase of building ownership and constituencies will require different leadership styles, communication skills, and mixes of incentives.

- *It is important to design and create institutions that will support reforms in the long term.*

Because political support will shift (or disappear or degrade, as in Mexico), it is vital to consider a phase of institution building—centered on developing and financing human resources—during the design of reforms.

- *International agreements can anchor and drive reforms.*

Because an international treaty with important partners, such as NAFTA, limits the discretion to unilaterally reverse reforms, it can work as a powerful "ratcheting" mechanism toward comprehensive reform. A treaty can also serve as a powerful argument in pushing for reforms against interest groups that support the status quo.

- *Market-based reforms require greater transparency and accountability, which take time to materialize, but new communication technologies can support institutional change.*

As reforms slowly sink in and are internalized in the political and administrative culture, adherence to principles of transparency and accountability becomes vital to supporting the market and maintaining trust in a modern regulatory state. Ensuring that the public administration adheres to these principles requires civil service reform through the development of rules and capacities (such as through administrative procedures or access to information laws). Empowering institutions such as Cofemer can also promote compliance. Importantly, new communication technologies such as the Internet can reduce the time and costs of institutionalizing transparency and accountability.

# APPENDICES

1. Chronology of Major Regulatory Management Initiatives, 1988–2000
2. Major Sectoral Regulatory Reforms, 1988–2000
3. Persons Interviewed
4. Statistical Information

# APPENDIX 1

## CHRONOLOGY OF MAJOR REGULATORY MANAGEMENT INITIATIVES, 1988–2000

| Date[a] | Initiative |
|---|---|
| 2-19-89 | Creation of the Economic Deregulation Unit (UDE) as a quasi-governmental agency under the purview of the Ministry of Trade and Industrial Development (Secofi) |
| 11-24-94 | Federal Administrative Procedures Law enacted. Set guidelines for administrative interactions between the government and private parties. |
| 11-24-95 | Agreement for the Deregulation of Business Activity issued, creating the first systematic regulatory reform program in Mexico. Specifically, it created the Federal Registry of Business Formalities and the process for deregulation of formalities, established mandatory review of regulatory proposals by the UDE, set the basis for the UDE's cooperation with state governments, and created the Economic Deregulation Council. |
| 12-16-96 | Agreement creating the first fast-track program for business start-ups in Mexico City. |
| 12-24-96 | Reforms to the Federal Administrative Procedures Law, introducing mandatory, public regulatory impact analysis at the federal level. |
| 5-20-97 | Reforms to the Federal Metrology and Standards Law. The reforms established an equivalency principle for the deregulation of technical rules and standards; regulatory impact analysis for the process of drafting and holding public consultation on standards; and a five-year sunset provision for technical rules and standards. |
| 4-19-00 | Amendments to the Federal Administrative Procedures Law, creating Cofemer and setting the main aspects of regulatory reform in law. These included:<br>■ Deregulation of formalities and the creation of the Federal Registry of Formalities and Services.<br>■ Mandatory review of all regulatory proposals of general application that create compliance costs for private agents and of the corresponding regulatory impact assessments.<br>■ A mandate for Cofemer to propose sector-specific reforms on its own initiative.<br>■ The basis for cooperation between the federal and state governments.<br>■ Mandatory presentation of biennial regulatory improvement programs by all ministries and regulatory agencies.<br>■ Extension of the scope of regulatory reform to asymmetric regulation of firms with market power. |

*Sources:* Authors; Cofemer 2003; Salas 2004.

a. The date refers to the publication of the reform in the official gazette *(Diario Oficial de la Federación).*

# APPENDIX 2

## MAJOR SECTORAL REGULATORY REFORMS, 1988–2000

- *Trucking and bus transportation* (1989–90). The entire sector was deregulated at the federal level, allowing a simple, transparent license and permit system, ending geographic restrictions, eliminating limitations on the loading and unloading of freight, and eradicating all price restrictions.

- *Electricity* (1992–93). A new electricity law and corresponding implementing rules made cogeneration and self-supply by independent producers possible.

- *Ports* (1991–93). Changes in the law made it possible for the private sector to obtain concessions for providing port services.

- *Land tenure* (1992). Far-reaching change in the ownership rights of poor farmers (*ejidatarios*) made possible all forms of rural business ventures. Domestic and foreign corporate entities may now own and use land for agriculture, livestock, and forestry production within certain legal limits.

- *Natural gas* (1995). The law was amended and regulations issued to allow private transport, storage, and distribution of natural gas. Transport permits are given on a first-come, first-served basis. The initial permit in each geographic zone is awarded by auction to the bidder offering the lowest end-user fee. The winning bid also sets the average revenue used as the basis for establishing the revenue cap for regulation.

- *Telecommunications* (1995). A new federal telecommunications law, enacted in 1995, allows asymmetric regulation of the dominant telephone carrier and the sale of radio spectrum through competitive bidding. New entrants in long-distance service began operations in 1997.

- *Civil aviation and airports* (1995–98). A new civil aviation law was enacted in 1995, with corresponding regulations issued in 1998. Prices and routes are no longer subject to government control, though routes where some carriers exhibit significant market power are monitored. Airport operations were opened to private investment in 1998.

- *Railroads* (1995–99). As a result of 1995 constitutional reforms, the national railroad company was divided into four separate companies and sold through competitive bidding.

- *Foreign investment* (1996). The ban on foreign entities owning land was lifted. Calculation of foreign investment in a restricted enterprise no longer takes into account minority foreign participation in the entities that would own the enterprise (if the entities are controlled by Mexican nationals). Limits on foreign investment in financial group holding companies were raised to 49 percent (up to 100 percent for U.S. and Canadian

nationals). With prior government approval, entities with majority foreign investment may now participate in the bidding for the privatization of airports and railroads.

- *Civil and commercial judicial procedures in the Federal District and in the state of Nuevo Leon* (1996–97). Court procedures in the capital were significantly streamlined, reducing the typical duration of a case from 2–3 years to 6–18 months. Between 1995 and 1997, the number of trials in Mexico City fell by 41 percent. Because unscrupulously delaying trial proceedings is now much more difficult, many more commercial disputes are being resolved outside the courts.

- *Guarantee trusts and mortgage securitization* (1996). Restrictions on the use of guarantee trusts in lending transactions were eliminated, increasing access to capital for small and medium-size businesses. Unnecessary mortgage registration and information requirements in Mexico City were removed, making it less costly for financial institutions to sell mortgage portfolios to one another and allowing the bundling and securitization of mortgages. The states of Aguascalientes, Campeche, Chiapas, Coahuila, Colima, Durango, México, Nayarit, Nuevo León, Oaxaca, Puebla, Quintana Roo, San Luis Potosí, Sonora, Tabasco, Veracruz, and Zacatecas have passed similar reforms.

- *Mining* (1996). The process for granting mining concessions was simplified through an auction system.

- *Environment* (1996). The Environment Law was substantially amended, rationalizing the use of environmental impact statements, allowing the introduction of tradable permits, and clearly delimiting federal, state, and local jurisdictions.

- *Health* (1997). Implementing rules for the General Health Law were modified to improve the administration of sanitary licenses and allow the creation of a generic drug market in Mexico.

- *Labor* (1997). Although the Labor Law has not been reformed, the implementing regulations related to worker training and safety and to labor inspection procedures were substantially simplified.

- *Pension funds* (1997). A major reform of the social security system allowed the creation of individual retirement accounts administered by competing fund management companies.

- *Bankruptcy* (2000) *and secured transactions* (1996 and 2000). New bankruptcy laws applying only to nonfinancial firms and secured transactions laws were enacted to improve the allocation of business sector resources and ease access to credit.

- *Property public registries* (2000). Public notaries can now use electronic means to submit a company's tax registration, reducing the number of days needed to set up a business. In addition, a federal, interlinked database was created.

# APPENDIX 3
## PERSONS INTERVIEWED

Sergio López Ayllón, researcher and professor, Centro de Investigación y Docencia Económicas (CIDE); former deputy head of Cofemer; former deputy counselor of the NAFTA Mexican team

Benjamín Contreras, former general coordinator, Cofemer; former general director, Energy Regulatory Commission

Rafael del Villar, director of economic studies, Bank of Mexico

Oscar Espinoza Villareal, consultant; former mayor of Mexico City; former head of Nafin (during the privatization of Telmex)

Jaime Zabludovsky, consultant; former deputy head of Office for the Negotiation of NAFTA former vice minister of international negotiation, Secofi; former ambassador to the European Commission

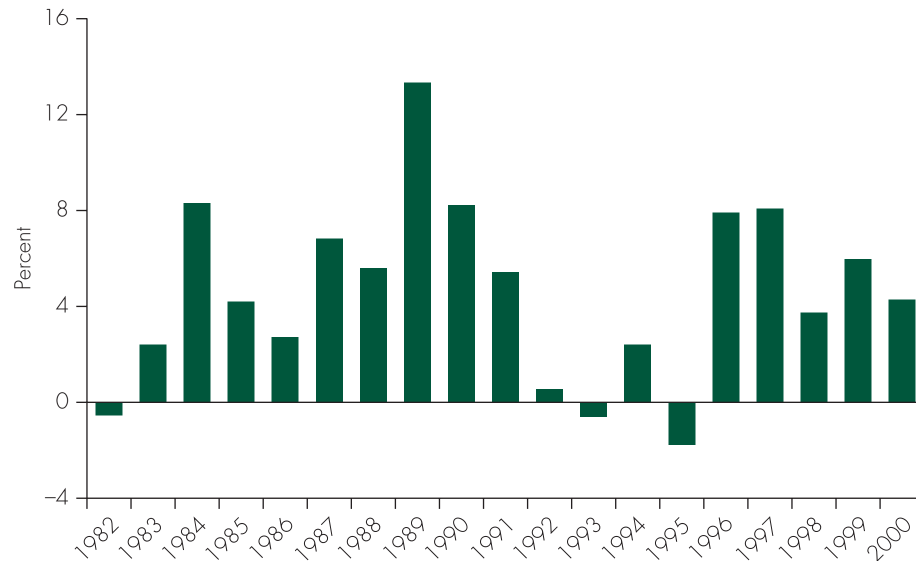
# APPENDIX 4

## STATISTICAL INFORMATION

FIGURE A4.1

### Change in Manufacturing Workers Registered with the Mexican Social Security Institute, 1982–2000

*Percent*




*Source:* Mexican Government. INEGI and the Mexican Social Security Institute (IMSS)

FIGURE A4.2

### Maquiladora and Agricultural Sector Workers Registered with the Mexican Social Security Institute, 1983–2003

*Source:* Mexican Government, INEGI and the Mexican Social Security Institute (IMSS)

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