

OECD Territorial Reviews: Mexico City

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Introduction

Mexico City's spectacular growth into one of the world's largest metropolitan regions is giving way to new development dynamics. The Metropolitan Area of Mexico City (MAMC), with a population of approximately 18.4 million people, is undergoing two main transitions: first, from high population growth to relative demographic stability and spatial redistribution, and second, from a declining manufacturing economy focused on national markets to one based on services competing internationally.

The MAMC has relevant growth potential linked to the concentration of headquarters and of education and research facilities, as well as rich cultural resources and high flows of foreign direct investment (FDI). However, potential growth is constrained by low levels of human capital, inadequate infrastructure and widespread acute poverty and insecurity. Furthermore, the current governance framework, characterised by modest co-operation between the different metropolitan governing institutions, represents an obstacle to the region's development and needs to be addressed.

The new pressures on Mexico City are metropolitan in scale and need to be addressed via a strategy that is more inclusive and that assumes logics of mutual interest and shared solutions across administrative jurisdictions. To enhance metropolitan competitiveness, action is needed in the fields of business development, skills development and urban regeneration. As regards governance, a strong political commitment should be built around a new metropolitan "vision". This should be accompanied by the introduction of incentive mechanisms to favour a climate of co-operation in designing and implementing a metropolitan development strategy capable of addressing the urgent challenges and exploiting the relevant potentials of Mexico City.

*This Policy Brief examines these issues and the policy recommendations put forward in the new publication, **OECD Territorial Reviews: Mexico City**. ■*

What new developments are affecting Mexico City?

Mexico City experienced **an extraordinary demographic expansion** during the period 1950-80. In 1950, the city's population was 2.9 million; by 1970 it had grown to 9.3 million, expanding rapidly into the State of Mexico. During the 1970s, and despite several programmes to promote urban de-concentration, the population increased by more than 50%, and the outward sprawl of the city intensified. Now the Metropolitan Area of Mexico City (MAMC) comprises 16 *delegaciones* (municipal delegations) belonging to the Federal District (FD), 58 municipalities from the State of Mexico and one from the State of Hidalgo. The period of uninterrupted growth and expansion is now giving way to significant shifts in the dynamics shaping the structure of the city. Within the metropolitan areas, old industrial core centres are re-structuring and parts of the population are re-locating to the peripheral municipalities of the State of Mexico that continued to grow at an average of 1.6% per year between 1990-2000. The Federal District accounted for 80% of the gross domestic product (GDP) of the MAMC in 1970, but this had fallen to 71% by 2000.

As a result of these trends, Mexico City has developed into a metropolitan region with a complex structure and not simply a wealthy, serviced core and poor, under-serviced periphery. For example, although the MAMC is relatively wealthy in aggregate terms, the region includes a large number of poor individuals, about 60% of the metropolitan population. The gap between accessible, safe, middle class municipalities and poorer, but often geographically-close, municipalities continues to increase. Particularly worrying is the trend towards **spatial polarization of increasingly impoverished segments of the population**. These

areas are often characterized by limited access to key services, such as healthcare and education, and low levels of security. The problem of security is not limited to such places but affects many other parts of the metropolitan area as well. This represents a major policy challenge because of its impact on the quality of life in the MAMC and also on the image of the area affecting its capacity to attract and retain investment and tourism. ■

Is Mexico City competitive in a global framework?

Overall, the MAMC, compared with other metropolitan regions across OECD countries, has a low real GDP per capita, mainly due to **low average productivity** (48% below the OECD average for metropolitan areas), the weaknesses of the labour market and the overall difficult framework conditions linked with poverty and low levels of infrastructure and basic services. A limited number of industrial branches (pharmaceutical, automotive, printing and publishing), characterized by high capital intensity, higher inflows of FDI, and trans-national operations have been responsible for some sector-specific growth and productivity gains. However, these examples of good performance do not appear to be spreading across the metropolitan area, where significantly weak levels of productivity prevail due to low educational attainment and investment in human capital development as well as insufficient links between research and industry to facilitate and diffuse innovation. Overall, the most defining characteristics of the metropolitan economy are the consolidation of the tertiary sector as the driving force of the regional economy (in 2003, it was estimated that 75% of the workforce was in the service sector), the decline of manufacturing, the reduced capacity of large firms to generate employment and to compete successfully in international markets, and the increasing reliance on micro and small firms in both the formal and informal sectors.

The transformation of the economy has had important consequences for the local labour market. Although the decline in manufacturing has been accompanied by an increase in service sector employment, the ability of the formal labour market to absorb former factory workers is limited. The gap between labour supply and demand has led to the development of a large informal sector, rather than open unemployment.

Despite such weaknesses, the MAMC possesses relevant competitive advantages and unused potentials. The large flow of FDI and the presence of corporate headquarters, together with the high level of producer services, the concentration of education and research facilities and the richness of the local historical and cultural heritage are all strengths upon which development can be built. ■

How to enhance the region's competitiveness?

Based on the assessment of the economic and social challenges facing the region, three areas can be identified for which policy action could improve competitiveness and have a positive impact on productivity and employment, bringing significant benefits to the whole region.

- **Business development** which focuses on bridging the technology and information gaps affecting small and medium-sized enterprises.
- **Human capital development** which focuses on bridging the skills gap, in particular ensuring access to training and re-training to improve the functioning of the labour market.
- **Urban development** which focuses on co-ordinating the different actions currently underway to re-vitalise the historical district of Mexico City, enhancing its potential as a tourist destination and triggering wider urban regeneration. ■

What are the keys areas for business development?

Despite the large presence of corporate headquarters in the region, close to 98% of all firms in the MAMC are in fact micro, small and medium sized enterprises, a large proportion with obsolete equipment, a weak culture of innovation, and poor access to new technologies. There is a wide technology gap between these firms and the relatively small segment of internationally competitive, export oriented firms in the region. While lack of access to modern equipment is a clear problem, lack of information about production methods and processes also appears to undermine the productivity of individual firms and whole sectors. Strong co-operative production chains, including links between SMEs and larger more competitive firms are hampered by weaknesses in areas such as standardization and quality control.

Addressing the technology and information gaps is critical to enabling small industries to achieve higher levels of productivity and reduce polarization of the economy. Mexico City includes many sectoral concentrations, but few are marked by strong co-operation processes.

Improving the capacity of small businesses to work together to seize common opportunities requires a more **focused approach to business development**. One such approach that provides effective tools to organise and deliver collective services is the use of **cluster policies**. ■

How to develop the MAMC's human capital?

As with the enterprise base of the region, the region's stock of human capital is adversely affected by under-investment and low efficiency of current education expenditures. **Imperfect matching of labour demand and supply** needs to be addressed to ensure that the current transition of the region's economy is not also accompanied by exclusion

and further reinforcement of the already large informal sector. Yet, as a result of several related factors – relatively poor coverage and limited access to upper secondary level education, few training options, and labour market structures that do not favour in-service training – the region is slow to adapt to demand for new skills. The challenge for the federal government is how to increase flexibility and reduce rigidities in the labour market while also strengthening the relative attractiveness of the formal sector and avoiding downward pressure on wages. These rigidities effectively reduce the incentives for enterprises to hire and train new employees. In the specific case of Mexico City, the uneven territorial distribution of adult education provision, combined with the sheer size of the metropolitan area, pose additional problems of access to training outside the firm.

Over the past few years, workforce development, combining training with decentralised active labour market policies has become a common focus for human capital development in a regional context. The concept is based principally on providing geographically targeted services that address imbalances across a regional labour market. This approach, particularly common in the US, would be an interesting approach also in the case of Mexico City, as a way of providing more flexibility despite rigidities in the national labour market framework. Evidence from several OECD countries suggests that private or semi-private not-for-profit organisations may have a major impact on labour force skills development activities. Such structures can make the link between strategic economic development planning and more sector or locality specific needs. They can ensure that funds from different public and private sources are pooled, or at least co-ordinated, and that an array of mostly bottom up specialised programmes are implemented in target areas. However, this is difficult to achieve through existing institutions in the Mexico City region, where resources are effectively separated according to administrative boundaries.

In Mexico City, there is a case for some functions to be undertaken through a cross-jurisdictional body such as the proposed Metropolitan Development Agency. An important innovation would also be **greater leverage of private sources of funding for human capital development activities.** ■

What about urban regeneration?

The potential for growth of the metropolitan tourism industry should not be overlooked. The Historical Downtown of Mexico City and other peripheral historical districts include around 1 500 sites registered in UNESCO's list of World Cultural Heritage sites. However, despite many programmes of reconstruction and rehabilitation (especially after the 1985 earthquake that damaged a large part of the city), the Historical Downtown of Mexico City is still characterised by depopulation, physical deterioration and the loss of many of its central functions. The area is of great importance since it is the symbolic centre not only of the metropolis but also of the country and has an immensely rich cultural, historical and architectural heritage. At present, there is a project to extend its perimeter to create the “Historical City of Mexico” declaring it an “area of protected heritage” under the General Law of Urban Development for the Federal District. Given the enormous symbolic and political meaning of this new territorial unity, its constitution could have a significant impact on the recovery of a cultural heritage that belongs to all Mexicans, thus improving the image of Mexico City, including its potential as a tourist location.

In this respect the MAMC could draw interesting experience from other historic city centres at the heart of dynamic metropolitan regions across OECD countries where major efforts at the metropolitan level have been channelled to renew and enhance the accessibility of historic sites. The common denominator in such experiences is the recognition that physical renovation is not sufficient but that economic and social dynamics have to be “invented” for

these areas. The pre-requisites for the regeneration of Mexico City's historical centre, other more peripheral historical districts and archaeological zones are a long-term commitment on the part of the public authorities, the involvement of civil society and the private sector, and a mechanism by which different actors can work together in a dynamic environment.

The strategic plan for the area must provide sufficient assurances to the private sector that current legal and regulatory frameworks, as well as levels of public investment, will be respected. At the same time, civil society expects that the public authorities will supervise participation by the private sector and ensure that development follows agreed plans and that decision-making processes are transparent and not bogged down by red tape.

All this explains why, in most cases, a quasi-governmental or not-for-profit agency is given that task of managing the project. In this scenario, civil society guides the public sector with respect to the desires and aspirations of citizens, the public authorities put in place a regulatory framework and provide incentives, and the private sector reacts to changes in the local market for investment. ■

What are the challenges to improving metropolitan governance?

In such a complex institutional system, and given the regional scale of most policy issues, effective co-ordination among the governments of the Federal District and the States of Mexico and Hidalgo is critical. Individually the different government entities have little power to effect radical change, so **the key question is how the national and regional governments can work together** according to their different competencies and legal powers. As such, solving the problems of the metropolitan region largely depends on more and better co-operation. The existing presence of co-ordinating bodies and planning instruments indicate that both the central government and

governments within the MAMC are well aware of the need for co-ordinated policy action in the metropolitan region, and over time the instruments used to encourage co-ordination within the region have evolved significantly. Nevertheless, there is still a sense that this has not translated into a metropolitan approach overall, and that effective collaboration is still a difficult and time-consuming process. The problem is not the lack of institutional mechanisms, but that the strongest policy implementation frameworks are organized along administrative-political lines and that, in comparison, "metropolitan" instruments are relatively weak. **The many institutions in charge of metropolitan co-ordination are not working under one common and widely shared metropolitan "vision"**. This generates confusion in what their respective objectives should be and in how their actions should be implemented, co-ordinated and monitored.

One of the main obstacles to effective co-ordination is the complexity of the fiscal system in the region. The Federal District and its *delegaciones* have a completely different fiscal regime from that operating in the states and their municipalities, generating varied levels of revenue, and with different expenditure responsibilities. The Federal District receives transfers (*participaciones* and *aportaciones*) from the federal government, but unlike the states it also has substantial own-tax revenue sources. As far as expenditures are concerned, the disparity between the Federal District and the states becomes even starker, particularly given that a large proportion of federal government expenditures in the region are concentrated in the Federal District where it retains some statutory functions. At the local level, there is little difference in spending between *delegaciones* or between municipalities in the MAMC. However, there is a substantial difference in spending between the Federal District as a whole and the State of Mexico as a whole. The Federal District spends almost twice as much per capita (8 097 pesos on average) as the MAMC municipal plus state spending in the State of Mexico (4 435 pesos on average). The combination of

asymmetries in revenues and expenditures between the Federal District and the rest of the MAMC, coupled with different administrative and regulatory regimes, makes co-ordination of policies and investments extremely difficult, imposing significant costs to the metropolitan economy.

The Review process has highlighted that the current system of metropolitan governance in the MAMC region suffers from three main weaknesses:

- **the lack of a clear and widely shared metropolitan vision;**
- **the presence of important fiscal and regulatory asymmetries;**
- **the urgent need for a new dynamic body capable of co-ordinating action in the field of economic competitiveness.**

In response to these three issues, the *OECD Territorial Review of Mexico City* suggests policy actions to give more practical reality to the currently weak concept of metropolitan policymaking. ■

How to create a shared metropolitan vision?

It is necessary to build political commitment and consensus behind the notion of metropolitan co-operation. An important first step would be to establish an initial clear statement of the shared interests of each entity and of the commitment to work towards a common vision of the role of the metropolitan region. Before the development of a strategy and of mechanisms to implement it, the nature of the metropolitan regional “project” needs to be clearly defined. It is also necessary to explain why the Federal District, the States of Mexico and Hidalgo and the individual *delegaciones* and municipalities depend on each other. This regional “vision” is essentially a statement of common interest and a commitment to co-operate towards common, agreed objectives. As with most other similar city-regions in OECD

countries, this vision needs to understand the different identities that it encompasses, promoting complementarities and interdependencies, but also recognising differences and distinctive characteristics. As a political charter, this statement should be patronised by the heads of government of the FD and the states, but elaboration of the vision on which it rests could be a more consultative process involving different public and private stakeholders. ■

Which fiscal tools could improve metropolitan co-operation?

The second important element of a new metropolitan governance framework would involve the **development of metropolitan resource sharing or reallocation mechanisms** to foster co-operation and a more efficient and accountable use of resources. Fiscal incentives to encourage co-operation, such as incentives in voluntary co-operation mechanisms, may be particularly useful in the MAMC. These mechanisms are being experimented with in many OECD countries. The idea behind them is to encourage co-operation by attaching certain conditions to transfers stipulating, for instance, that funds for projects can only be obtained when more than one government participates. These incentives and other contract mechanisms may assume different forms, but should possess three main characteristics. First, an upper-level government (such as the central government) is involved in setting the rules of the game. In the case of the MAMC, the rules would presumably attempt to elicit co-operation among municipalities, between states and municipalities, or between states, and might be limited to infrastructure improvements in primary areas such as water or transportation. A second characteristic is competition for funds. Project proposals are evaluated in terms of quality and not all projects are funded. The third characteristic is co-financing. To obtain funding, applicant governments may be required to commit resources themselves and/or have some commitment of resources from other public or private parties. ■

How could a Metropolitan Development Agency help Mexico City?

With respect to building competitiveness, there is a need for a more flexible and dynamic means by which to implement policies effectively. The priorities for competitiveness described above imply both a cross-sectoral approach and a strong business environment focus. A **Metropolitan Development Agency**, acting as the principal implementing agency for a competitiveness strategy for the region, would co-ordinate actions in different fields relating to improving the productivity of firms in the region, increasing investment (e.g., in the historic centre) and skills development. Overall, it would possess the following characteristics common to most regional development agencies in OECD countries:

- The mission and general objectives are defined by the sponsoring public agencies involved to whom the agency is accountable.
- It is responsible for translating overall objectives into operational projects and programmes.
- It has a strong labour market and enterprise focus, including responsibility for organising, or at least

co-ordinating, regional business support and work-force development programmes.

- It is responsible for, or closely involved in, inward investment promotion and processing, and more generally is responsible for contributing to the marketing of the region.
- It works with local development agencies or sectoral agencies that are delivering outputs that contribute to achieving the general objectives (e.g., it does not replace specialised bodies).

Such a body would be constituted so as to maintain close links with the different government entities of the entire region, while being institutionally separate from them. The principal concern is to ensure that it can implement an approach to policy delivery that provides what the public authorities cannot in terms of flexibility, business linkages and sensitivity to local needs. ■

For further information

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For further reading

- OECD (2004), **OECD Territorial Reviews: Mexico City**, OECD Publications, Paris. www.oecd.org/bookshop.
- OECD (2003), **OECD Territorial Reviews: Mexico**, OECD Publications, Paris.
- Visit our territorial governance website at www.oecd.org/gov/territorialgovernance.

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