

**WORKSHOP ON COMPETITION ASSESSMENT IN THE CONTEXT OF THE REGULATORY IMPACT
ASSESSMENT**

**CASE STUDY
INTRODUCTION TO THE REGULATORY INTERVENTION**

Patents in Mexico

In Mexico, the intellectual property system is governed by the Industrial Property Law, the Federal Law on Copyright and other regulations. Among its objectives there is the "industrial property protection through regulation and granting of patents for inventions; registry of profit models, industrial designs, trademarks and advertising slogans; publication of trade names, statement of protection of denominations of origin, and regulation of trade secrets". Thus, one of the ways through which creation is protected and innovation and technological development are fostered, is through the granting of patents, which gives exclusive rights to operate to companies, individuals, institutions or research centers that make innovations or inventions of industrial application. In this way, as in other countries, the Mexican government seeks to remedy the **problem of sub-optimal investment** that is systematically recorded in the field of research, due to the positive externalities of it.

Responsible institution

- Mexican Institute of Industrial Property

Additional information

- The use of the patent system is concentrated in just five patent offices (U.S., Japan, South Korea, China and the European Union), where about 75% of patents worldwide are granted.
- In 2006, the U.S. Patent Office granted 5,908 Korean patents and only 66 Mexicans.
- Mexico is a member of the Patents Cooperation Agreement (PCT) which allows users to obtain protection in multiple jurisdictions through a single international application. In 2010, the country registered 191 patents in the World Intellectual Property Organization (WIPO); in 2011 it rose to 225 and in 2012 decreased to 190 (in comparison, in 2006 the U.S. recorded about 50,000 patents).

Session_1.2_Breakout_Regulatory_intervention

Reflection elements

- From the economic point of view, is this regulatory intervention justified? What market failure is present?
- Can the granting of patents be seen as an artificial creation of temporary monopolies for successful innovations or inventions?
- Can a market failure as externalities be solved with another market failure as monopolies?
- Can the granting of these monopolies generate a cost in terms of social welfare?
- From the point of view of the authority, what else can encourage research and solve the problem of a smaller-than-socially-optimal investment?
- According to the data presented above, can we say that Mexico is achieving the objective of promoting research?



Exercise: Regulatory Interventions and market failures

For each program listed below, mention what is the market failure that could be considered as a justification for government intervention:

1. Pollution regulations for automobile use or industrial activities
2. National defense
3. CONACYT Scholarships
4. Institute for the Protection of Bank Savings
5. Rules that require the seller of a used car to be subject to a technical verification before the transaction (i.e. technical control in France)
6. Urban Conservation
7. Postal Service
8. Prohibitions on the use of drugs
9. Regulation establishing interconnection costs in the Mexican rail system
10. Rules regulating the labeling of processed foods

Exercise: Regulatory Interventions and market failures

Suggested answers

1. Pollution Regulations for automobile use or industrial activities

We talk about an example of **externalities**, in this case, a negative one. When a highly polluting car is used it affects the air quality and, therefore, costs are imposed to other people without compensating them for it. Since the driver does not bear all the costs of the externality that generates, he produces too much pollution. The regulation aims to limit the incidence of negative externalities. Therefore, if there is no government intervention, pollution would be too high.

Similarly, a plant that discharges its waste into a river, for example, imposes costs on its water users, who would have to spend considerable resources to clean the water. Regulation could require a waste treatment process in order to limit the negative externalities and "internalize" their costs by the plant that generates it. The cost the individuals who perform activities that generate pollution face or have to pay is less

than the true cost society faces, meaning the cost of the damage is not absorbed by those who generate pollution, which seeks to remedy, in this case, through regulation.

1. National defense

This is a case of **public goods**. This is because there is no additional cost for each individual who enjoys its benefits or, in other words, there is no additional cost to defend a country of 1,000,000 people or to defend one of 1,000,001 people. On the other hand, if the national defense policy is successful in ensuring the integrity of the territory, all citizens benefit and there is no way to exclude some (not exclusion).

1. CONACYT Scholarships

We talk about an example of **externalities**, in this case, a positive one. See explanation in Appendix taken from COFEMER and Latin-Reg, *Primer Diplomado en Regulación*, 3ª lectura, módulo I, Febrero 2012, pp.26-27.

1. Institute for the Protection of Bank Savings

It addresses a case of **incomplete markets**. The IPAB is a decentralized body of the APF, sectorized to the Treasury, whose functions are regulated by the Law for Bank Savings Protection and the Law on Credit Institutions. Its legal mandate is to manage the bank savings protection system in Mexico, in benefit of savers.

Some economists believe that private markets have not been able to provide sufficient insurance offer, which justifies government intervention. You might think that the market would offer insurance or guarantee savings, however this is not the case. The reason why these markets are imperfect has undergone extensive studies in the past two decades. The reason could be high transaction costs, since it is costly to introduce to the market new insurance policies. Insurers may have a high aversion to design a new insurance policies if they are not sure that it will have a demand. Moreover, the causes could include **information asymmetries**. The insurer does not have all the information about the nature and extent of the solvency of banks and the risks they take by investing the savings of depositors. If insurers overestimate the risks, the cost of the policy would be too high and no one would buy them, whereas if they underestimate it there would be demand for those policies, but insurers would end up losing money. When there are significant information asymmetries, markets may not exist.

1. Rules that require the seller of a used car to be subject to a technical verification before the transaction (i.e. technical control in France):

It serves an **asymmetry of information**. While a used car will be cheaper than a new one, the buyer bears the risk that the car can give him problems in the future because it does not have all the information of its technical condition. A new car, although is more expensive, incur less risk of mechanical failure. Information asymmetry arises because the car owner has information that the buyer does not have. The market failure exists because the seller of a good quality car is not going to get what his vehicle is really worth, the existence of defective vehicles on the market punishes the market price of used cars in general, even if they are in good condition. In addition, buyers can not differentiate between a vehicle in good or bad condition, as it punishes the price of the first and the buyer must assume that only the latter persist in the market.

In France, the cars must undergo a technical inspection every two years, and you cannot sell a used car if you do not have this certification (and, indeed, the buyer will ask the seller for this certificate). This measure is intended, among other things, to minimize the asymmetry of information in the transaction.

1. Urban Conservation

This is a case of **public goods**. The market does not produce sufficient without government intervention. When a municipality repaves streets, remodels public buildings, parks, sports fields, etc. incurs in a cost that does not increase in proportion to the number of people who transit through the street, for example. In addition, the fact that a person travels on the street, does not prevent another one to do it (non-rivalry) and, in general, is not possible to exclude anybody from the benefits of conservation (not exclusion).

Here we present the case of *free riders*, being those who do not pay taxes that pay for urban conservation. If this was done by the market, those who may benefit most would be willing to pay, but since many people would benefit without paying, gradually the incentive to pay for urban redevelopment by the private sector would disappear.

1. Postal Service

We refer to a **lack of competition**. The operation of a postal service with national and international range requires a high level of infrastructure, which generates high fixed costs that not everyone can assume. Although there might be enough demand, the market is still "naturally concentrated." The government, not the market, defines postal service prices and, in some countries like the U.S., there exists regulators of the postal service. Furthermore, in the postal services market, the average cost of a single operator are much lower than the average costs that would be observed if there were two or more participants.

1. Prohibitions on the use of drugs

We talk about an example of **externalities**, in this case, positive, and could be treated also as a case of **information asymmetries**.

Drug use generates different damages to society. On the one hand, there are costs to the health sector for the treatment of addicts. On the other hand, one can derive multiple indirect effects such as higher crime rates, insecurity, aversion of entrepreneurs to invest, etc. The one who consumes drugs does not assume all these costs that society must bear in different ways. The regulations that prohibit the use of drugs to try to limit the scope of these costs. If regulation results effective, it would generate multiple positive externalities. However, its effectiveness is being questioned recently.

1. Regulation establishing interconnection costs in the Mexican rail system

We refer to a **lack of competition**. See explanation in Appendix taken from COFEMER and Latin-Reg, *Primer Diplomado en Regulación*, 3ª lectura, módulo I, Febrero 2012, pp.19-21.

1. Rules regulating the labeling of processed foods

It serves an **asymmetry of information**. These rules pretend to give consumers relevant data on the quality and content of processed foods in order to allow consumers to make purchasing decisions in an informed way. The consumer usually does not know well the contents on processed foods, whether they include risky products, levels of fat, sugar, etc. The labeling requirement seeks to minimize this asymmetry, making information transparent.