Role of competition policy in structural reform: Mexico’s experience

Kenneth Smith Ramos

Bangkok, Thailand
April 2009
Competition policy in Mexico derives from Art. 28 of the Constitution ...

Art. 28 of the Constitution
“In the Mexican United States, monopolies, monopolistic practices, and tax exemptions are forbidden according to the terms and conditions established by the laws. [...]”

- “Enforceable in the entire Republic and applicable to all economic activities” (Art. 1)
- Creation of the Federal Competition Commission (CFC)
- Definition of monopolistic practices (absolute and relative)
- Merger control
- Establishment of proceedings and sanctions

Note: Article 28 of the Constitution defines exceptions to the general prohibition to monopolies, and monopolistic practices; the same exceptions are considered in the FLEC.
... and has been a key element of Mexico’s economic modernization

- Competition has been one of the main drivers to modernize the Mexican economy.
  - The Federal Law of Economic Competition came into effect in 1993
  - The FLEC created the Federal Competition Commission

- In addition to these tools, competition has been enhanced by:
  - Market opening
  - Deregulation
  - Macroeconomic stability
Mexico shows an important lag in economic growth …

Projected annual economic growth
Change in real GDP, %

Notes: * Includes Hong Kong, Korea, Singapore and Taiwan.
** Includes Germany, France, Italy and Spain.
Source: International Monetary Fund (IMF), World Economic Outlook, October 2008.
... which is due in part to an inefficient resource allocation given the lack of competitive pressures in several economic sectors.

**Short run:**
- Improve market efficiency
  \[ \rightarrow \] Optimize resources

**Long run:**
- Invest in education, health, capital
  \[ \rightarrow \] Expand production possibilities

**Current situation**

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**Competition promotion**
In Japan, for example, the most productive sectors are those exposed to more international competition...

**DUAL ECONOMY IN JAPAN**

11 Industries

Relative productivity levels
Index U.S. = 100

- Steel
- Automotive parts
- Metal working
- Cars
- Consumer electronics
- Computers
- Soap and detergent
- Beer
- Food processing
- Retail
- Housing construction

Employment
100% = 12.473 million employees

Main activities of the CFC

- Investigating **collusive agreements** between competitors.

- Investigating **unilateral conducts** by firms with market power.

- Analyzing proposed **mergers**.

- Issuing **recommendations** to Federal, State and Local governments on how **to improve regulations** so that these can become pro-competitive.
Competition policy is a key element to boost competitiveness and economic growth in Mexico. Important obstacles to competition still remain.

Mexico is at a crucial moment to make amendments to the regulatory framework in regulated sectors to promote competition and increase competitiveness as well as consumer welfare.
Regulated sectors which have horizontal impact throughout the economy deserve special attention

Economic activity
- Competitiveness
- Investment
- Growth

Transport
Telecommunications
Financial services
Energy

Regulated sectors
High impact of governmental action
In Mexico, substantial inefficiencies are present in regulated sectors …

**Telecommunications**

Mexico's place among OECD members
30 economies, prices in USD PPP

<table>
<thead>
<tr>
<th>Service</th>
<th>Intensity of use</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>High</td>
</tr>
<tr>
<td>Residential fixed line telephony</td>
<td>7th most expensive</td>
</tr>
<tr>
<td>Business fixed line telephony</td>
<td>4th most expensive</td>
</tr>
<tr>
<td>Mobile telephony</td>
<td>10th most expensive</td>
</tr>
<tr>
<td>Broadband Internet (price/MBps)</td>
<td>3rd most expensive</td>
</tr>
</tbody>
</table>

*Instituto Mexicano para la Competitividad (2005). Hacia un pacto de competitividad*

**Financial services**

Banking system profitability (ROE)
Earnings after taxes / Average capital, 2005

<table>
<thead>
<tr>
<th>Country</th>
<th>Prom.</th>
<th>Min.</th>
<th>Max.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico</td>
<td>5.2</td>
<td>0.7</td>
<td>23.5</td>
</tr>
<tr>
<td>USA</td>
<td>12.7</td>
<td>12.3</td>
<td>17.7</td>
</tr>
</tbody>
</table>

Operative efficiency of banking system
Operative expenditures / Average of assets

<table>
<thead>
<tr>
<th>Country</th>
<th>Prom.</th>
<th>Min.</th>
<th>Max.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico</td>
<td>5.4</td>
<td>0.7</td>
<td>6.0</td>
</tr>
<tr>
<td>USA</td>
<td>5.7</td>
<td>5.3</td>
<td>5.8</td>
</tr>
</tbody>
</table>


**Energy**

Average industrial rate for electricity
Dollar cents per KWh, September 2008

<table>
<thead>
<tr>
<th>Country</th>
<th>Rate (Dollar cents per KWh)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico</td>
<td>$12.90</td>
</tr>
<tr>
<td>USA</td>
<td>$7.36</td>
</tr>
</tbody>
</table>

Source: Mexican Secretary of Energy, and the US Energy Information Administration.
National and international institutions agree that competition is a key factor to address low competitiveness and growth in Mexico

“[La] falta de competencia, particularmente en la provisión de insumos básicos para la producción … propicia el deficiente desempeño del resto de los factores. Es urgente eliminar las barreras existentes para la entrada a los mercados.”

“Para estimular la productividad de las empresas y mejorar su competitividad se requiere más competencia en los mercados.”

“Mexico’s competition environment, regulatory framework and investment climate are major priority areas to increase Mexico’s competitiveness.”

“Mexico needs stronger competition and better regulation to boost productivity and growth.”

“Strengthening competition (…) should also have high priority, and –as international experience has shown- may also facilitate reform in other areas as well as helping equity.”

“Mexico’s goods markets suffer from inadequate (foreign and domestic) competition conditions, with overregulated and rather closed key economic sectors. Only by addressing these challenges can Mexico begin to fully leverage its important competitive advantages.”

Sources: Banxico, Presentation of Guillermo Ortiz before the British Trade Chamber, December 6th, 2007
IMCO, Punto de inflexión: Situación de la competitividad de México 2006
World Bank, Mexico 2006-2012: creating the foundations for equitable growth, June, 2007
IMF, Mexico: Staff report for the 2007 Article IV consultation
In order to take bigger steps to improve the sectoral regulatory framework, coordination with the Ministry of Economy (SE) and sectoral regulators is critical.
The OECD’s Competition Assessment Toolkit provides a general methodology for identifying regulatory barriers that restrict the free functioning of markets.

Agreement

In September 2007, Mexico and the OECD signed an agreement to implement the OECD’s Competition Assessment Toolkit.

Resources

The Mexican government allocated a specific budget for the implementation of this project.
In order to separate political considerations from the technical analysis, the project includes a High Level Consultative Group (HLCG) and a Technical Group.

Responsibility in competition analysis

- Discuss different policy options presented by the Technical Group.
- Recommend specific modifications to Laws and regulations.
- Draft the implementation plan of recommendations.
- Analyze regulation to detect restrictions to competition process.
- Present policy options to resolve problems.
The Technical Group will present proposals in three phases

- **4-6 months**
  - CFC opinions
  - Maturity period of the initial work of experts

- **12-15 months**
  - Output by experts
  - Periodic delivery of analysis and proposals made by the Technical Group based on the work of experts

- **2-3 months**
  - Measures to follow-up on recommendations
  - Technical Group proposals to extend the reform exercise

Discussion and definition of policy recommendations by the High Level Consultative Group
In **phase one**, the Consultative Group will discuss the proposals contained in CFC opinions

Key opinions by CFC to promote competition principles in the regulatory framework

<table>
<thead>
<tr>
<th>Sector</th>
<th>Topic</th>
<th>Date issued</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telecommunications</td>
<td>Technological convergence</td>
<td>31/10/2005</td>
</tr>
<tr>
<td>Financial services</td>
<td>Pension funds</td>
<td>22/11/2006</td>
</tr>
<tr>
<td>Financial services</td>
<td>Credit cards</td>
<td>24/04/2007</td>
</tr>
<tr>
<td>Energy</td>
<td>LP Gas bylaw</td>
<td>27/07/2007</td>
</tr>
<tr>
<td>Transportation</td>
<td>Airports</td>
<td>01/10/2007</td>
</tr>
<tr>
<td>International trade</td>
<td>Tariff structure and customs simplification</td>
<td>19/05/2008</td>
</tr>
</tbody>
</table>
In May 2008, the CFC recommended international trade reforms to increase competition and competitiveness.

On Dec. 18, 2008, the Mexican Government announced three trade reforms incorporating many of CFC’s recommendations:

<table>
<thead>
<tr>
<th>CFC Recommendation</th>
<th>Government Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Reduce the level and dispersion of the tariff structure</td>
<td>1. Gradual reduction in tariffs for industrial products in a way that will generalize the benefits of sectoral programs</td>
</tr>
<tr>
<td>2. Simplify customs procedures</td>
<td>2. Simplification of administrative procedures for foreign trade and customs operations</td>
</tr>
<tr>
<td>3. Eliminate barriers to entry for the provision of customs clearance services</td>
<td>3. Promotion of competition and efficiency in services connected with customs clearance</td>
</tr>
</tbody>
</table>

The trade reform proposal was the first one to be implemented, from among the proposals made by CFC as part of the competition assessment project.
The CFC recommendations have been of significance for Trade and International Competition ...

- Because it affects a broad range of non-agricultural imports.
  ✓ Products subject to the reductions constituted 50% of Mexican imports in 2007, with a value of USD 141,608 million

- Previously, the highest tariff rate applicable to industrial goods was 50%.
  ✓ With the reforms, it will be 20%

- The average tariff rate on industrial products will go from 10.4% to 4.3%.
  ✓ Over 4300 tariffs will be reduced to zero

- When the reforms are fully in effect, Mexico will have moved from being among the countries (along with Brazil) with the highest MFN tariff levels in Latin America to being one of the most liberalized economies in the region.
  ✓ This reform has been characterized as “the most ambitious unilateral tariff reduction of the last 20 years”
With respect to the CFC proposals to promote competition in the Consumer Banking Credit Market …

<table>
<thead>
<tr>
<th>The current situation</th>
<th>CFC proposals currently under discussion</th>
</tr>
</thead>
<tbody>
<tr>
<td>In Mexico, users face difficulties to compare different options of Bank Consumer Credit.</td>
<td>Promoting measures that facilitate the user’s mobility, and increase transparency in banking services.</td>
</tr>
<tr>
<td>Moreover, banks (where users have their accounts) impose barriers to those users that want to move (or cancel) their accounts and banking services to another bank.</td>
<td>Including measures that promote competitive access to essential facilities.</td>
</tr>
<tr>
<td>Incumbent banks have the control of essential facilities to compete in the credit market.</td>
<td>Establishing minimum access conditions to services such as switches and credit bureaus.</td>
</tr>
</tbody>
</table>

- In a bill presented to the Congress in December 2008, which included the CFC proposals, it was detected that figure of correspondent banks was excessively limited.
- During the same month, the CFC issued an opinion that promoted the elimination of unnecessary restraints to correspondent banks, and the consolidation of this financial figure.
- The current bill discussed by Congress does not include the considerations that limited correspondent banks, and therefore it can be seen as a tacit approval for the CFC proposal.
The topics to be analyzed in **phase two** were chosen based on their impact on the economy.

<table>
<thead>
<tr>
<th>Sources</th>
<th>Criteria</th>
<th>Topics</th>
</tr>
</thead>
</table>
| IMCO, OECD, World Bank | Sectors with horizontal impact on competitiveness                        | • Telecommunications  
                                                                                   • Financial services  
                                                                                   • Energy  
                                                                                   • Freight transportation |
| INEGI, COLMEX    | Sectors with significant participation in consumer expenditure            | • Corn and tortilla  
                                                                                   • Carbonated beverages  
                                                                                   • Beer  
                                                                                   • Passenger transportation  
                                                                                   • Dairy  
                                                                                   • Egg and poultry  
                                                                                   • Paper industry  
                                                                                   • Personal and home care  
                                                                                   • Insurance  
                                                                                   • Retail banking  
                                                                                   • Medicines and hospital services  
                                                                                   • Pensions |
| CFC experience   | Horizontal regulation with a high impact on competitiveness              | • Fiscal policy  
                                                                                   • International trade  
                                                                                   • Subsidies  
                                                                                   • Technical regulations |
Eight initial studies have been selected, to be developed simultaneously

<table>
<thead>
<tr>
<th>Topic</th>
<th>Expected outcome</th>
<th>Period</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Interconnection in telecoms</strong></td>
<td>Policy and regulatory changes that ensure efficient interconnection conditions</td>
<td>4 months</td>
</tr>
<tr>
<td><strong>2. Financing to SME’s</strong></td>
<td>Measures to provide competitive financing for SME’s</td>
<td>4 months</td>
</tr>
<tr>
<td><strong>3. Electricity</strong></td>
<td>Policy proposals to optimize State intervention and improve efficiency</td>
<td>4 months</td>
</tr>
<tr>
<td><strong>4. Pharmaceutical products</strong></td>
<td>Actions aimed at eliminating unnecessary regulatory restraints to competition</td>
<td>4 months</td>
</tr>
<tr>
<td><strong>5. Agriculture</strong></td>
<td>Supporting the efficient functioning of markets</td>
<td>4 months</td>
</tr>
<tr>
<td><strong>6. Credit cards</strong></td>
<td>Proposals to increase competition in the payments systems and credit cards market</td>
<td>4 months</td>
</tr>
<tr>
<td><strong>7. Fiscal policy</strong></td>
<td>Regulation measures and a pro-efficiency tax policy</td>
<td>4 months</td>
</tr>
<tr>
<td><strong>8. Potential benefits of Competition Assessment Framework</strong></td>
<td>Calculation of welfare impact of competition measures in key sectors of the economy</td>
<td>4 months</td>
</tr>
</tbody>
</table>
In phase three, follow-up mechanisms will need to be designed in order to extend the life of the project.

Australian experience in the design and implementation of the National Competition Policy

Hilmer Report: General principles for reform

- Political consensus
- Legal framework
- Implementation
  - Institutional framework
  - Federal Regulation review
  - Reform at State level (incentives)
The Technical Group consists of hired experts and CFC officials …
... who will have complementary roles

<table>
<thead>
<tr>
<th>Participant</th>
<th>Involvement</th>
<th>Tasks</th>
</tr>
</thead>
<tbody>
<tr>
<td>CFC officials</td>
<td>Oversight</td>
<td>• Work coordination</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Validation of the analyses and proposals</td>
</tr>
<tr>
<td>Local experts</td>
<td>Part time</td>
<td>• Drafting of specific studies</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Discussion of studies in the Technical Group</td>
</tr>
<tr>
<td>OECD experts</td>
<td>Full time</td>
<td>• Advice on international practices</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Horizontal collaboration in studies</td>
</tr>
<tr>
<td>Legal Expert</td>
<td>Part time</td>
<td>• Legal advice to specific studies</td>
</tr>
<tr>
<td>Analysts</td>
<td>Full time</td>
<td>• Support to experts (research, analysis)</td>
</tr>
<tr>
<td>International adviser council</td>
<td>Review</td>
<td>• Review and comment on specific studies</td>
</tr>
</tbody>
</table>
Participation of a Council of Academic Advisors and two waves of reviews

• The CFC is performing a two-phase review process of the studies carried out under the Toolkit:

  ➢ First level review:
    - OECD experts in Paris: Competition Division, Trade, Telecoms used so far
    - OECD experts in Mexico: senior competition lawyer and senior competition economist

  ➢ Second level review:
    - New Council of Academic Advisors: six former Chief Economists from US competition agency
    - Senior consultants from US, Europe and Latin America
To ensure the success of this exercise, it is necessary to follow some basic principles for the design and evaluation of proposals.

NATIONAL COMPETITION POLICY REVIEW

Chairman: Prof Frederick G Hilmer
Members: Mr Mark Rayner
Mr Geoffrey Tapevell

Secretary: Mr Warrick Smith

25 August 1993

The Committee thus approaches its task with a strong presumption favouring universal and uniform coverage of the market conduct rules proposed in this Part. Moreover, consistent with the principles agreed to by the Heads of Governments, it will be seeking to ensure:

- that any exceptions from such universal coverage are only permitted on public interest grounds;
- that claims of public interest are assessed by an appropriate transparent assessment process, with provision for review; and
- that reforms in this area are consistent with the development of an open, integrated domestic market for goods and services and, in recognition of the increasingly national operation of markets, reduce complexity and eliminate administrative duplication.

Source: National Competition Policy, Report by Independent Committee of Inquiry (Reporte Hilmer), p. 87
The Australian Experience and Regulatory Reform in Mexico

- As part of the Toolkit, in February 2009, the CFC had the opportunity to work with another senior economist from the OECD to study Regulatory Reform aspects in Mexico at the sub-national level.

- This consultancy was aimed at examining the Australian experience with a comprehensive program of pro-competitive regulatory reforming involving three levels of government: federal, state, and municipal.

- As the World Bank Doing Business Project has highlighted, there is scope for some States to make substantial improvements that would help foster competition and thus improve the competitiveness of the entire Mexican economy.

The purpose of the consultancy was to identify lessons from the Australian experience that could be applicable to Mexico.
...and some of the conclusions are:

- Implementation of the **National Competition Policy Agreements** is widely recognized to have substantially **enhanced the competitiveness of the Australian economy through fostering competition**, although more could still be achieved.

- The **key distinguishing features** of the National Competition Policy reform were not the specific sectors that were reformed, or even actual reforms that were undertaken (as many similar reforms have been implemented individually elsewhere), but the basic **design that created incentives for the implementation of a broad package of reforms**.

- The same could be adapted to other federal countries like Mexico, given the widespread prevalence of transfers from Federal to sub-national governments, and thus the opportunity to link these payments to reforms that grow the economy.
The Australian experience has shown that a reform conducted under these principles can decisively foster economic growth.

**Australia versus OECD—real GDP growth**

* 3-year moving average

Source: Frederick G. Hilmer’s presentation to the OECD Competition Committee. February 20, 2008