Regulatory Reform in Mexico

Government Capacity to Assure High Quality Regulation

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FOREWORD

Regulatory reform has emerged as an important policy area in OECD and non-OECD countries. For regulatory reforms to be beneficial, the regulatory regimes need to be transparent, coherent, and comprehensive, spanning from establishing the appropriate institutional framework to liberalising network industries, advocating and enforcing competition policy and law and opening external and internal markets to trade and investment.

This report on *Government Capacity to Assure High Quality Regulation* analyses the institutional set-up and use of policy instruments in Mexico. It also includes the country-specific policy recommendations developed by the OECD during the review process.

The report was prepared for *The OECD Review of Regulatory Reform in Mexico* published in 1999. The Review is one of a series of country reports carried out under the OECD's Regulatory Reform Programme, in response to the 1997 mandate by OECD Ministers.

Since then, the OECD has assessed regulatory policies in 16 member countries as part of its Regulatory Reform programme. The Programme aims at assisting governments to improve regulatory quality — that is, to reform regulations to foster competition, innovation, economic growth and important social objectives. It assesses country's progresses relative to the principles endorsed by member countries in the 1997 *OECD Report on Regulatory Reform*.

The country reviews follow a multi-disciplinary approach and focus on the government's capacity to manage regulatory reform, on competition policy and enforcement, on market openness, on specific sectors such as telecommunications, and on the domestic macro-economic context.

This report was principally prepared by Scott Jacobs and Cesar Cordova-Novion, in the Public Management Service of the OECD. It benefited from extensive comments provided by colleagues throughout the OECD Secretariat, as well as close consultations with a wide range of government officials, parliamentarians, business and trade union representatives, consumer groups, and academic experts in Mexico. The report was peer-reviewed by the 30 member countries of the OECD. It is published under the authority of the OECD Secretary-General.

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Is the national administration able to produce social and economic regulations that are based on core principles of good regulation? Regulatory reform requires clear policies and the administrative machinery to carry them out, backed up by concrete political support. Good regulatory practices must be built into the administration itself if the public sector is to use regulation to carry out public policies efficiently and effectively. Such practices include administrative capacities to judge when and how to regulate in a highly complex world, transparency, flexibility, policy co-ordination, understanding of markets, and responsiveness to changing conditions.

Since the early 1980s, the pace, scope, and depth of Mexico's structural reforms have exceeded those of most other OECD countries. Policies of privatisation, market openness, public sector modernisation, competition enhancement, and regulatory reform have substantially reduced the direct role of the state in the economy, strengthened competitive market forces, and in some sectors, boosted the efficiency of regulation needed to protect public policies and promote competition. This process of deep structural change, still underway, has been accelerated by a transformation of the political landscape toward a multi-party system, the rapid development of federalism in governance structures, and integration of the North American economy through NAFTA. As part of these changes, regulatory decision-making moved from opaque and highly centralised processes, in which policy decisions at the centre were undermined by weak policy implementation at lower levels, toward more decentralised, flexible, transparent and accountable approaches. These changes have moved Mexico closer to good international regulatory practices. By end-1998, Mexico had established a solid policy, legislative and managerial basis at the national level for addressing the serious regulatory problems that remain.

In 1989, Mexico launched its first explicit regulatory reform policy to improve economic performance and to stimulate entrepreneurial energies. The reform programme expanded in three stages: (1) sectoral deregulation was followed by (2) improvements to sectoral regulatory frameworks, which were complemented by (3) efforts to establish a government-wide regulatory quality control system based on critical review, transparency, and consultation. Government capacities for carrying out regulatory reform have been built over the past six years, including enactment of laws (such as an administrative procedure law and a law on standard-setting) to improve regulatory transparency and other aspects of regulatory quality.

Since 1995, the current administration has reinforced these capacities through implementation of a broad review programme for new regulations and existing formalities, launching of a co-operative programme to help states and municipalities improve their regulatory frameworks, and establishment of new government-wide regulatory reform tools, such as regulatory impact analysis, a Federal Registry of Formalities, and an equivalence test to speed the adoption of performance oriented regulatory alternatives. Several of these initiatives are good practices that should be considered by other OECD countries. These regulatory initiatives were supported and implemented through new institutions, such as a ministerial-level Economic Deregulation Council, a team in the Ministry of Trade and Industry, and specialised regulatory agencies for telecommunication, energy and competition policy. The judicial branch is being strengthened and modernised, though there is room for further progress in fortifying the role of judicial review of the use of administrative discretion.

Attention needs to shift now to implementation of the regulatory reform agenda over the medium-term. Despite large investments made in good regulatory policies and laws, the full benefits have not yet been realised by citizens and businesses on the ground, and could be lost without a multi-year period of policy stability and determined implementation to allow the reforms to take hold. During the present transition phase when old and new still coexist, the contradictions between a market-oriented policy regime, a rigid administrative environment, and a complex and inflexible legal framework must be worked through. For example, the transition to a transparent, accountable, and results-oriented public administration has far to go. Some ministries have not made the cultural leap to a less interventionist role, and there continue to be weaknesses in policy implementation by federal, state, and local bureaucracies. In the new political context, the constituency for reform must be broadened to the general public and Congress to consolidate and build on past achievements.

The OECD's policy options for Mexico are to:

- *Establish consistent government-wide standards for regulatory quality by closing gaps, eliminating exemptions in the current policy framework, and expanding the review programme beyond "business" regulations to all significant regulations.*

- *Further improve transparency by extending legal requirements for notice and comment procedures, already required for technical standards, to all ministries and agencies during the development and revision of regulation. Procedures for openness should be standardised for all advisory bodies.*

- *Improve the efficiency, independence and accountability of the new regulatory agencies by strengthening their systems of governance, policy coherence, working methods, and relations with the competition authority. A first step should be the launching of a comprehensive and independent review of the performance of the new regulatory agencies, followed by appropriate revisions to their missions, authorities, and work methods in laws and other regulations.*

- *Promote quality regulation by transferring the CDE/UDE to a location at the centre of government with cross-cutting management and co-ordination authorities, such as the President's office, and by strengthening its attention to consumer protection and citizen welfare.*

- *Strengthen disciplines on regulatory quality in the ministries and agencies by refining tools for regulatory impact analysis, lawdrafting, and use of alternatives to regulation, and training public servants in how to use these tools for regulatory quality.*

i) Require that RIAs be systematically published during the notice and comment process for each regulation;

ii) Train public sector employees in how to conduct regulatory impact analysis.

iii) Promote the adoption of alternatives to traditional regulation by developing guidance and training.

iv) Improve regulatory clarity and simplicity through better lawdrafting.

- *Speed up effective reform by adopting a systematic and comprehensive approach to the review of existing laws and regulations.*

- *Review laws and regulations to improve concession processes.*

- *Further encourage regulatory reform by co-ordinating with the states and helping them to develop management capacities for quality regulation.*

1. THE INSTITUTIONAL FRAMEWORK FOR REGULATORY REFORM IN MEXICO

1.1. The administrative and legal environment in Mexico

Recent years have seen a transformation of the Mexican state that has involved profound changes to the style and content of regulation. Sweeping modernisation launched in the 1980s and 1990s was aimed at changing government's relations with society toward more transparent and decentralised forms. Recent events such as the congressional elections of 1997 indicate the existence of a pluralistic and open political system, which will reinforce the trend to a more transparent, responsive and accountable public administration in which clientelist relations are diminished. These changes are still underway, but important progress has been made in a brief period, ranking Mexico among the OECD's best performers in terms of the speed with which regulatory reform is advancing toward international standards of good practice. An understanding of the present situation and future trends is possible only by reviewing the basic features of the former system.

A centralist tradition. For most of this century, Mexico's system of governance could be characterised as bureaucratic, hierarchical, and centralised.[1] This was exemplified in the *de facto* one-party system, in which the *Partido Revolucionario Institucional* (PRI) dominated national and state politics for nearly 70 years, since the founding of the modern Mexican state. This centralised pattern could be seen in both the "vertical division of power" (between federal, state and local governments) and in the "horizontal division of power" (between the legislative, executive and judicial branches).

In the "vertical" dimension, Mexico is divided into 31 states and a federal district for Mexico City. Each of these has an elected governor, an assembly, and a state judicial system and is further divided into municipalities. Each of the 2 377 municipalities is governed by a municipal president and a small rule-making council. This is not obviously a centralised state. For example, the Constitution formally gives important regulatory powers to sub-national levels of government (see Section 2.3 below). In practice, however, political and policy power, supported by national controls over fiscal and budget decisions, has accumulated at the centre, and the federal government has also made most regulatory decisions.

Concerning the "horizontal" division of power, the federal government was itself centralised. The president at the top—also the *de facto* head of the PRI—exerted a near monopoly of power vis-à-vis the legislative branch and exerted strong influence through administrative, legal and constitutional reforms of the judicial branch.[2] The two elected chambers of Congress, the Senate, and the Chamber of Deputies, together with the Supreme Court, deferred in practice to decisions taken by the president and ministers. Legal proposals were prepared by a small staff in a single ministry. After being signed by the president, they were sent to the Congress who rapidly approved and enacted them, often in less than a week. In contrast, the constitutional grant of power to Congress and the states to initiate and enact laws was, until recently, never used.[3] The Constitution itself was a policy and regulatory tool, and was frequently revised to support policy decisions, some concerning the economic role of the state.

A strongly hierarchical approach to public administration exerted a powerful and long lasting influence on public service culture. All members of the Cabinet and the chief executives of regulatory agencies are directly appointed by the president. Each minister or chief executive then builds a team that is personally loyal. With few exceptions, there is no career civil service in the administration. The public administration is staffed by a mixture of unionised and non-unionised bureaucrats with different incentives for performance and service quality improvement. The unionised group is guaranteed job security, but its

promotion opportunities are limited. In contrast, the second group of non-unionised "technocrats" is largely in control of public institutions but, though they have a higher level of income, they face uncertainty, do not have a clear professional development path and lack compensation if they lose their jobs. Most policy-making powers are centralised in the minister and his/her personal team, who are usually in place for only a few years, in the face of high turn-over.

Effective control by a small and temporary group of high officials over most of the government's decision-making mechanisms has important impacts on the design and implementation of regulatory reform. On the positive side, in the period leading up to the current co-habitation between the government and Congress, policy coherence is more easily assured, and legal reform can happen very quickly and forcefully when there is agreement in this group to move forward. On the negative side, such centralisation can also reduce government efficiency, transparency, and accountability. Understanding and control of the implementing capacities of the administration by this group is weak, and longer-term institution-building is neglected in favour of short-term policy announcements. Simple regulatory decisions, such as approvals, are checked at higher levels, creating severe delays in regulatory processes. Periodic transfers of top officials from one position to another diminish long term commitment and policy stability, as well as institutional memory when implementing policies. There is little follow-up or accountability in terms of results achieved. In some cases, implementation never takes place. Furthermore, the hierarchical culture based on loyalty to superiors is so strong that *de facto* independence of regulatory agencies from the sectoral ministries is hard to establish (see Section 3.4). In sum, the "top down" approach to policies, can make implementation of programmes and reforms confused in form or substance, delayed, or even non-existent.

A complex regulatory framework. Paralleling the rigid, centralised administrative system is a complex, legalistic, and rigid regulatory system. Under Mexico's civil law system, regulations are hierarchically organised, each one explicitly based on a superior rule until it refers to a specific article of the Constitution. In 1998, this pyramid-like structure was composed of 258 laws, 2 111 international treaties, 374 presidential regulations ("*reglamentos*"), 766 presidential decrees or agreements, and 585 mandatory standards known as *Normas Oficiales Mexicanas* (NOMs). The Constitution caps this federal framework. The legal structures of state and municipal governments are similarly organised, with individual state constitutions forming the point of the pyramids of state laws and regulations. An added complexity arises where states' regulations involve a sharing of regulatory responsibilities with the federation and the municipalities, for instance in environmental protection and water management (see Section 2.4).

After enactment by the Congress, laws are made effective by promulgation (*i.e.* signed and ordered into effect) by the president and publication in the Federal Official Gazette (*Diario Official de la Federación*). By constitutional mandate the president, as head of the executive, has broad powers to execute, interpret and enforce laws through a variety of regulatory instruments, the most important being the *reglamentos*. Previous to the current regulatory management policy, regulators could establish lower level subordinate regulations and requirements, such as formalities or NOMs, with traditionally few constraints on their discretion in exercising those powers.

Important features of the legal framework contribute to a rigid administration that is often more concerned with procedural duties than delivering good policy results. As in all civil law countries, the legal system of Mexico is based on the concept of certainty. In practice, this implies an effort to develop written legal codes with as much detail as possible. Unlike in a common law system, implementing laws and regulations are, under the Mexican constitution, meant to be an "exhaustively complete code of rules, procedures, rights, and duties for [the authorities as well as for the citizens] ... Rules may not be implied, but rather must be expressly spelled out".[4] Articles 27, 28 and 73 of the Constitution not only define the

general objectives and scope of government intervention but specify the activities and sectors subject to state monopoly. In a similar manner, laws, rather than lower-level regulations, tend to enumerate all the procedures with which a business must comply.

Reliance on detailed laws did not, however, avoid delegation of broad discretionary powers to regulators because the laws tended to concentrate on a mass of procedural details ("rights and obligations") rather than on setting down substantive criteria for decisions (policy results). Hence, for example, regulators must examine information whose provision is mandated by law, but have more freedom on how to weigh the information in their decisions. Too, the accumulation of procedures increased the arbitrary nature of administration, because it was impossible to know or comply with all requirements, leaving administrators to decide which rules to enforce, and how. Similar to experiences in the United States, the pursuit of certainty in regulations produced so much complexity and detail that they reduced the performance of the whole.[5] Paradoxically, then, the Mexican legal system seems to be characterised by both too much detail and too much discretion.

Lastly, Mexico's legal environment consists of a complex web of linkages and cross-references which includes laws, subordinate regulations and other delegated instruments. In the extreme (but not completely unusual) case, business requirements can be derived from two different laws and several sets of subordinate regulations which cross federal and state jurisdictions.

Some of these features make reform, revision and replacement of existing regulations a major and laborious process of co-ordination and re-drafting, if the consistency of the system is to be preserved, and policy objectives of reform are to be achieved.

Until very recently, the administrative setting and the legal framework were able to coexist in relative harmony, though policy effectiveness suffered. Weaknesses in the judicial branch encouraged a low level of compliance and enforcement, consistent with the capacities of the administration. A huge gap existed between, on the one hand, the real legal environment where since the colonial period "the law was to be obeyed, but not fulfilled" and, on the other hand, the constant search for a perfect, but impractical legal system.[6] Previous to the current composition of Congress, the predominance of the Executive branch permitted constant legal reform, overriding the structural rigidity of the system. For instance, though a change in the Constitution must be achieved via a procedure requiring approval by a two-thirds majority of the Senate and approval by each state's assembly, from 1917 to 1996, 346 amendments were made to its 136 articles. Subsequently, these modifications slowly trickled down to the lowest levels of regulation.[7]

The strongly executive-driven nature of governance allowed a small reforming elite to accomplish an impressive "silent revolution" of the Mexican legal system over the past 15 years to support the ambitious economic modernisation programme. It is during this period that most of the government capacities and initiatives discussed in this report were launched. Between December 1982 and December 1994, 107 new laws were enacted and 57 were reformed out of a total of more than 200 laws in force at that time. In effect, 80% of the legal framework was extensively modified. The pace of change accelerated in the last 6 years of this period, when 61 new laws entered into force (see Box 2 for the major economic regulatory activities). The aggregate effect of these legislative reforms was to support the establishment of market mechanisms and links to a globalised economy (*i.e.* market openness) through reducing the state's role in market structure (*i.e.* privatisation), in its functions (*i.e.* deregulation), in its relationship with the other constitutional branches of government (*i.e.* political, electoral and judiciary reforms), with the states and municipalities (*i.e.* decentralisation) and with citizens in general (*i.e.* transparency and administrative procedures).[8]

Paralleling this astonishing legislative transformation are changes to the traditional governance system forced by internal factors. In the past few years, the centralised system has rapidly lost ground. A multi-party system has emerged, and in 1997, the PRI lost control of the lower house of Congress for the first time. Today, federal, state and municipal governments operate in a more pluralistic setting with greater balance between the effective powers of the arms of the state. An active federal Congress and local assemblies are learning to exert their autonomous regulatory powers. Civil society is demanding a more transparent and accountable State. As new voices enter the debate and a new balance is found between executive and legislative powers the public debate about regulatory reform is becoming more vigorous, supporting the trend toward good regulatory practices. Support by the new Congress for continued movement toward market-oriented policies will be essential to sustain reform and reap the benefits of past reforms.

During the present transition phase where old and new uneasily coexist, the contradictions between a market-oriented policy regime, a progressively less rigid administrative environment, and a complex and inflexible legal framework raise important questions about the future of regulatory reform.

Box 1. **Good practices for improving the capacities of national administrations to assure high-quality regulation**

The OECD Report on Regulatory Reform, which was welcomed by Ministers in May 1997, includes a co-ordinated set of strategies for improving regulatory quality, many of which were based on the 1995 Recommendation of the OECD Council on Improving the Quality of Government Regulation. These form the basis of the analysis undertaken in this report, and are reproduced below.

A. BUILDING A REGULATORY MANAGEMENT SYSTEM

1. Adopt regulatory reform policy at the highest political levels.

2. Establish explicit standards for regulatory quality and principles of regulatory decision-making.

3. Build regulatory management capacities.

B. IMPROVING THE QUALITY OF NEW REGULATIONS

1. Regulatory Impact Analysis.

2. Systematic public consultation procedures with affected interests.

3. Using alternatives to regulation.

4. Improving regulatory co-ordination.

C. UPGRADING THE QUALITY OF EXISTING REGULATIONS

(In addition to the strategies listed above)

1. Reviewing and updating existing regulations.

2. Reducing red tape and government formalities.

1.2. Recent reform initiatives to improve public administration capacities

Rapid industrialisation of Mexico in the 1950's and 1960's, in what is known as the period of stabilised development, was fostered in a domestic economy highly protected by tariff and non-tariff barriers. In this environment, the economy grew at an average rate of 6.5% from the 1950s until the early 1980s. Governments relied on an economic growth model that featured subsidies and protectionist measures to encourage development of a private sector oriented to producing substitutes for imports. Restrictions on direct foreign investment were accompanied by steady expansion in tariff protection and quantitative restrictions. Fiscal incentives and subsidised credit programmes were enjoyed by sectors deemed to be a priority. Regulations were pervasive in the economy, favouring a selected group of industries and controlling business entry and operations. While achieving some of their objectives, the regulations had negative consequences, such as diminishing competitive pressures, reducing flexibility and discouraging efficient changes among producers. Accumulating rigidities and inefficiencies culminated in the debt crisis of 1982 and painful adjustment that has taken many years to work through.[9]

The process of economic structural change that began in 1983 continues today. This process has been built on two pillars. First, public finances had to be put on a sound footing to strengthen the government's ability to influence macroeconomic variables. To achieve this goal, the government's size and its role in the economy had to be redefined. Secondly, the government sought to expand the space for market-driven decisions in order to promote a more efficient economy. To this end, the government has gradually withdrawn from its role as a producer in various markets and has allowed market forces more latitude in determining the allocation of resources.

Box 2. **List of major sectoral regulatory reforms since 1990**

Trucking and bus transportation (1989-1990). The entire sector was deregulated at the federal level, allowing for a simple and transparent license and permit system, the end of geographic restrictions, the elimination of limitations on the loading and unloading freight, and the eradication of all price restrictions.

Electricity (1992-1993). The new electricity law and corresponding implementing rules made co-generation and self-supply by independent producers possible.

Maritime transportation (1991-1993). Changes in the law allowed for the private sector to obtain port services concessions.

Land tenure reform (1992) A far reaching modification of ownership rights of poor farmers (*ejidatarios*) to allow all forms of rural business ventures. Domestic and foreign corporate entities may now own and operate land for agriculture, livestock and forestry production within certain legal limits.

Natural Gas (1995). The law was amended and by-laws (*reglamentos*) issued in order to allow private transportation, storage and distribution of natural gas. Transportation permits are given on a first-come first-serve basis. The initial permit in each geographic zone is allocated through an auction in which the bidder offering the lowest end-user fee is declared the winner. The winning bid also sets the average revenue from which the revenue cap regulation is begun.

Telecommunications (1995). A new Federal Telecommunications Law was enacted in 1995, allowing for asymmetric regulation of the dominant telephone carrier and for the sale of the radio spectrum through a competitive bidding process. New entrants in long distance telephone services began operations in 1997.

Civil aviation and airports (1995-1998). A new Civil Aviation Law was enacted in 1995, and its corresponding *reglamento* in 1998. Prices and routes are no longer subject to government control, except for monitoring of routes where some carriers exhibit significant market power. The opening of airport operations to private capital began in 1998.

Railroads (1995-1999). As a result of 1995 Constitutional reforms, the national railroad company was divided into four separate companies and sold through a competitive bidding process.

Foreign Investment (1996). The ban on foreign entities owning land was removed. 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 was raised to 49% (up to 100% for US and Canadian Nationals). With prior government approval, entities with majority foreign investment may now participate in the bidding for the privatisation of airports and railroads.

Civil and mercantile judicial procedures in the Federal District and in the State of Nuevo Leon (1996-1997). Court procedures in the capital were significantly streamlined, reducing the typical case's duration from two to three years to six to 18 months. From 1995 to 1997, the number of trials in Mexico City decreased by 41%. Because it is now much more difficult to delay trial proceedings unscrupulously, many more commercial disputes are being resolved outside the courts.

Guarantee trusts and mortgage securitisation (1996). Restrictions on the use of guarantee trusts in lending transactions were eliminated, thereby increasing access to capital for small and medium size businesses. Unnecessary mortgage registration and information requirements in Mexico City were removed, reducing the costs of selling mortgage portfolios between financial institutions and enabling the bundling and securitisation of mortgages. The states of Nuevo León, Aguascalientes, Campeche, Chiapas, Coahuila, Colima, Durango, México, Nayarit, Oaxaca, Puebla, Quintana Roo, Sonora, San Luis Potosí, Tabasco, Veracruz and Zacatecas have also passed similar reforms.

Mining (1996). The process for the granting of mining concessions was simplified through implementation of an auction system.

Environment (1996). The entire Environment Law was substantially changed, rationalising the use of environmental impact statements, allowing for the introduction of tradable permits, and clearly delimiting federal, state and local jurisdictions.

Health (1997). Implementing rules for the General Health Law were modified in order to improve the way in which sanitary licenses are administered and to allow for the creation of a generic drugs market in Mexico.

Labour (1997). Although the Labour Law has not been reformed, the implementing regulations related to worker training and safety, and to labour 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.

Two general strategies—privatisation and free trade—served as the framework and starting point for regulatory reform in Mexico. A huge privatisation process transferred commercial activities from the public to the private sector and the free trade program dramatically increased competition. The embracing of market policies called for a new regulatory framework that would clearly define the rules of the game and give certainty to investors. These policies were supported by two other strategies of reform: the emergence of a structured competition policy and the modernisation of the public administration.

Privatisation of State-owned enterprises. Through liquidations, mergers, transfers, and sales, the number of government-owned companies fell from 1 155 in 1982 to fewer than 200 in 1996. This process significantly reduced the proportion of employment and production accounted for by the public sector. At the same time, privatisation was an important short-term financing source for the government.

Opening markets. After initial and modest liberalisation efforts, Mexico launched a rapid and far-reaching liberalisation of the manufacturing sectors as part of the stabilisation and adjustment programme after the debt crisis of 1982. The aims were to expand the tradable sector and open the economy to international competition to encourage efficiency in exporting and import-substitution activities. Trade liberalisation accelerated in 1986 with accession to GATT, resulting in the correction of relative prices and reduction of price distortions. Further steps included bi-lateral and multilateral trade negotiations, the most important of which was the North American Free Trade Agreement (NAFTA) which went into effect on 1 January 1994.

GATT did not have a major direct impact on the regulatory framework, except for those regulations directly related to trade, such as standards. Regulations concerning non-tradable sectors remained more or less untouched. This was not the case with NAFTA. This wide-ranging trade treaty had important impacts on the regulatory framework (compelling reforms to investment law, patent protection law, etc.) and significant implications for the competitiveness of previously unreformed sectors and policy areas including services, investment and even the rule of law. It was also important in establishing a number of disciplines in the Mexican regulatory system that were deemed necessary to market openness and a level playing field (*e.g.* consultation mechanisms, transparency, conflict resolution mechanisms).[10]

Deregulation and regulatory improvements. From the end of the 1980's, these structural reforms were complemented by a major overhaul of laws and regulations to improve the functioning of markets. A deregulation policy was not explicit in the structural reforms in 1982, when the government concentrated on privatisation efforts related to fiscal consolidation. However, since the beginning of the administration of President Salinas in 1989 an explicit national policy on regulatory reform has been in place and has steadily expanded in scope and ambition. An important element of this strategy was the creation in 1989 of an economic deregulation unit called the *Unidad de Desregulacion Economica* (UDE) in the Ministry of Trade and Industry, *Secretaria de Comercio y Fomento Industrial* (SECOFI).

The Mexican regulatory reform effort can be divided into three periods.[11] At its beginning, the UDE concentrated on deregulating or re-regulating specific economic sectors to facilitate the flow of goods, services and capital stimulated by the trade liberalisation measures. The UDE also worked with other ministries to establish new regulatory frameworks for privatised infrastructure sectors such as telecommunications and harbours. Secondly, the deregulation effort focused on adapting a broader range of regulations to an open economy to provide a level playing field between existing and new firms regardless of their origin inside or outside Mexico. Thus private, including foreign, participation was allowed in strategic service sectors such as public infrastructure (for instance in highways, municipal public services and co-generation and self supply of electricity) to attract international investment Other important programmes pursued in this context were the deregulation of financial services and the reform of land ownership.

By the early 1990s, this economic deregulation programme had broadened to include an effort to review obsolete and inadequate regulations and build the necessary micro economic conditions to increase efficiency and lower costs in all markets. This second stage of reforms was driven by the advancing pace of structural reforms induced by external competition and investment attraction. The reforms aimed at providing legal certainty and eliminating contradictions, thus reducing transition costs and facilitating decision-making. The UDE originated three crucial laws: the Federal Metrology and Standards Law (*Ley Federal de Metrologia y Normalizacion*), the Consumer Protection Law (*Ley de Proteccion al Consumidor*), and the Competition Law (*Ley Federal de Competencia*) (see Box 3).

The administration of President Zedillo in December 1994 commenced a new phase of reform. Three considerations were paramount during preparation of the new policy. First, regulatory reform was central to the recovery strategy after the peso devaluation of late 1994. Second, although the previous programme was regarded as successful, its selective approach based on targeting priority sectors to maximise efficiency gains was considered too slow and partial. The business community considered that the administration had placed too much importance on minimising political costs, and had avoided reforms that would have confronted some powerful interests. Business representatives also wanted to include reforms aimed at what they saw as the high costs of social and environmental, as well as sub-national, regulations, all of which had previously been beyond the scope of reform policy. Last, from the viewpoint of a government struggling with a budgetary crisis, regulatory reform was the form of "industrial policy" which was least fiscally demanding.

In late 1995, a comprehensive policy, called the *Acuerdo para la Desregulacion de la Actividad Empresarial* (ADAE), was enacted in a new executive order, and was confirmed a few months later in the National Development Plan. It gave the UDE greater review powers, created an Economic Deregulation Council (CDE) and, most important, established a scrutiny process for new regulatory proposals and existing formalities (see Section 2.1 below).

Box 3. **Milestones in managing regulatory reform in Mexico**

1989 (February): Creation of the UDE through an executive order: the *Acuerdo por el que la SECOFI Procedera a Revisar el Marco Regulatorio de la Actividad Economica Nacional*.

1992 (July): Federal Metrology and Standards Law enacted. It establishes for the first time a regulatory process with a detailed consultation procedure and a cost-benefit analysis requirement for new technical standards.

1992 (December): Federal Competition Law enacted. It establishes modern antitrust regulations and creates an independent Federal Competition Commission.

1994 (December): *Ley Federal de Procedimiento Administrativo*. Clarifies important aspects of the regulatory process, in particular concerning appeal rights.

1995 (November): *Acuerdo para la Desregulacion de la Actividad Empresarial* (ADAE) Creation of the Economic Deregulation Council. The UDE gains more review powers and a review process for existing formalities and new regulations is established.

1996 (December): Reforms to the Federal Administrative Procedure Law, regulatory impact analysis (RIA) mandated for all new regulations.

1997 (April): Reforms to the Federal Metrology and Standards Law. The cost-benefit analysis is replaced by a RIA. A five yearly sunsetting mechanism and a fast-track procedure to eliminate obsolete technical standards (NOMs) are established, and a performance oriented system for new standards is encouraged.

Competition policy. Competition policy is central to the restructuring of the Mexican economy that was closely tied to the deregulation efforts. While previous initiatives had been taken in this area, it was in 1993, with the entry into force of the Federal Economic Competition Law that an explicit policy was launched to modernise competition policy. The UDE authored the new law, and co-authored its "*reglamento*", and the first president of the competition authority was its former chief (see background report to Chapter 3 for details).

Modernisation of Public Management. In parallel with previous reforms, the Mexican federal government launched a broad policy of administrative modernisation based on two axes: administrative simplification, and a systematic effort to eliminate unethical and corrupt practices in the bureaucracy. These programmes have been managed by the Ministry of the Comptroller General (*Secretaria de Contraloria y Desarrollo Administrativo* or SECODAM). Recently, the modernisation programme has focused on four areas: citizens service and participation, decentralisation and delegation of public administration powers, measurement and evaluation of public management performance, and reform of human resources policy in the public sector.[12]

2. DRIVERS OF REGULATORY REFORM: NATIONAL POLICIES AND INSTITUTIONS

2.1. Regulatory reform policies and core principles

The 1997 *OECD Report on Regulatory Reform* recommends that countries adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation.[13] The 1995 *OECD Council Recommendation on Improving the Quality of Government Regulation* contain a set of best practice principles against which reform policies can be measured.[14]

Since 1989, Mexico has had an explicit national policy, set out in an executive order (*Acuerdo Presidencial*), on reforming regulation. In November 1995, President Zedillo ratified and expanded it through the executive order named Agreement to Deregulate Business Activities (the ADAE).[15] It is designed to increase the competitiveness of Mexico's businesses and promote job creation by reducing and streamlining requirements for the establishment and operation of firms, specially SMEs, by limiting bureaucratic discretion, and by reducing uncertainty in commercial transactions due to obsolete laws and the high cost of using the courts to enforce contractual obligations. It also aims to enhance the transparency of the regulatory process by making draft regulations available to the private sector through a ministerial-level Economic Deregulation Council (CDE) and, since October 1998, publishing weekly the list of draft regulations under review on the CDE's Internet website.

The ADAE spells out both regulatory reform criteria and a permanent process for reviewing regulations in detail. Thus, reform is transformed from a "one off" initiative into a systematic and permanent review process. It significantly increases the UDE's powers to implement the policy, and sets out several important elements:

– Review and reform of all existing federal business formalities (stock).[16]

– Review and reform of all new administrative or legislative proposals (flow).

– Proposal of economy-wide legislative reforms to improve Mexico's regulatory framework.

– Support to regulatory reform programmes at state and local levels.

The ADAE reviews have, as an explicit policy goal, "deregulating all requirements and response time needed to start up and operate a business in Mexico imposed by federal authorities".[17] This goal makes clear that, consistent with its roots in the economic modernisation programme, the ADAE is primarily producer oriented, concentrating on deregulating government requirements on businesses but excluding other regulatory policies affecting consumers or citizens. Oddly, given the broader nature of reforms in Mexico, the ADAE does not mention improving the efficiency of markets, increasing competition, or improving trade openness. Moreover, no consumer protection organisation or association, which are undeveloped in Mexico, is a statutory member of the CDE.

Consistent with OECD recommendations that governments establish principles of good regulation to guide reform, the ADAE has explicit standards for regulatory quality. The following five criteria are used as a check list in the review process:

- There must be a clear justification for government involvement. Regulations must be vehicles for the processing of government services or must respond to concrete economic or social problems such as health or environmental hazards, or inadequate consumer information.
- Regulations must be maintained or issued only on evidence that their potential benefits exceed their potential costs.
- There should be no regulatory alternatives that can accomplish the same objectives at lower cost.
- Regulations must minimise the negative impact they have on business, especially small and medium size businesses.

Regulations must be backed by sufficient budgetary and administrative resources to ensure their effective administration and enforcement.

The content of these quality standards is comprehensive and well-conceived, and compares favourably to regulatory quality standards in place across the OECD area, and in the OECD Recommendation of 1995 (the OECD Recommendation was, in fact, an input to the policy). The inclusion of a check on implementation capacities is a useful response to systematic implementation weaknesses in the regulatory system. Although it is named the "deregulation" programme, the ADAE also established for the first time a regulatory management system which in practice creates an on going "better regulation" exercise. The implicit focus (in the benefit/cost test) on using good regulation to improve social welfare rather than only seeking ways to reduce business costs mitigates to some degree the unduly narrow business-oriented goals of the ADAE. The visible focus on business costs probably reflects the need to maintain strong support for the programme among the ministry's business constituency, though the programme itself is pursuing broader regulatory quality goals. Further emphasis on an overall policy for better regulatory quality controls in the future, including but going beyond minimisation of business costs, should boost the social gains from the programme and help broaden the appeal of the programme to a wider constituency. One important and continuing gap, however, is the absence of any principle on public consultation or transparency beyond the creation of the high-level CDE.

The ADAE review powers were supplemented in 1996 and 1997 by modifications to the Federal Law of Administrative Procedures and the Federal Law of Metrology and Standardisation that introduced a Regulatory Impact Analysis implemented by the UDE (see Section 3.3).

Together, the ADAE and these legal changes established a broad framework of principles for regulatory quality, covering most existing and proposed federal regulations regardless of legal form. However, the policy framework has important gaps in its scope. In addition to regulations without business impacts, the UDE does not review:

- Regulations related to contributions (taxes and payments made to the federal government), the financial sector, federal government property, public servant obligations, electoral regulation, agrarian and labour justice, and those established by the Justice (*Procuraduría* General) and Defence Ministries (but the UDE automatically reviews any business formalities contained on these regulations).
- Regulations related to the IMSS (Mexican Social Security Institute), the INFONAVIT (national housing funding agency), concessions, government procurement and public works (but the UDE can review any business formalities contained in these regulations *if* it and the CDE explicitly request them).

2.2. Mechanisms to promote regulatory reform within the public administration

Reform mechanisms, including the allocation of explicit responsibilities and authorities for managing and tracking reform inside the administration, are needed to keep reform on schedule. As in all OECD countries, Mexico emphasises the responsibility of individual Ministries for reform within their areas of responsibility. But it is often difficult for ministries to reform themselves, given countervailing pressures. Further, maintaining consistency and systematic approaches across the public administration is necessary if reform is to be broad-based. Mexico has established a series of centralised oversight mechanisms for implementation of the reform programmes considered in Section 2.1 above.

Two main bodies promote regulatory reform in Mexico: at the political level, the ministerial council for Economic Deregulation (CDE), and at the expert administrative level, the Economic Deregulation Unit (UDE) in the Ministry of Trade and Industry. The CDE is at the centre of the promotion programme. The CDE is chaired by the Minister for Trade and Industry who reports directly to the president. In practice the CDE acts as Mexico's supreme regulatory policy forum. Other standing members of the CDE are the Comptroller General as vice-chair, the Ministers of Finance and Labour, the Governor of the Bank of Mexico, five representatives of the business sector, four representatives of the academic sector, three from the labour unions and two representatives of rural workers.

The ADAE establishes accountability for performance of regulating ministries by instructing them to name a deputy minister responsible for the implementation of their regulatory reform programmes and inviting them to report periodically to CDE. This has provided the CDE, and the UDE acting as its technical secretariat, with enhanced leverage in their negotiations with agencies. It has also improved incentives for ministries to place regulatory reform higher on their list of priorities.

The full CDE meets approximately six times a year and its executive commission approximately every six weeks. During these meetings, proposed reforms and reports on the implementation of previously approved reforms are discussed. Most of the recommendations taken by the CDE are prepared by its executive commission. This high-level group is co-chaired by the chief of the UDE and the Head of the Deregulation Programme of the Mexican Business Council (*Consejo Coordinador Empresarial*—CCE), and is attended by representatives at vice ministerial level of the members of the CDE. Depending on the topics, other vice ministers, state officials, academics or concerned parties are invited. A detailed performance indicators table summarising the state of reform and supported by a comprehensive list of approved and implemented proposals is presented in each meeting. The executive commission establishes *ad hoc* advisory working groups in order to prepare reform proposals. Co-ordinated by a UDE desk officer, these working groups concentrate on a particular body of regulation within a ministry. Their main function is to provide technical advice to the executive commission in the form of detailed proposals.

As the technical secretariat of the CDE, the UDE manages the programme. It also reports directly to the Minister of Trade and Industry as counsellor on regulatory matters. The UDE is staffed by 16 to 20 officials, mostly economists and lawyers, and is supported by consultants and advisors. Its main task is to formulate and analyse reform proposals and prepare the programme's activities to be presented to the CDE. The UDE is organised around specific "desks" dealing with particular ministries. Each desk officer is responsible for organising reviews, preparing reform proposals for CDE opinion, and following up the implementation of commitments by the ministries. Since January 1998 desk officers have also been in charge of reviewing regulatory impact analyses prepared by the ministries.

The Office of the President's Legal Counsel (*Consejeria Juridica del Executivo Federal*—CJEF) has been an important driver in regulatory reform. CJEF reviews all law proposals to be sent to Congress and all the implementing regulations that require the signature of the president (*i.e. Reglamentos, Decretos y Acuerdos Presidenciales*). The main formal functions of the CJEF are to verify the constitutional adequacy of proposed regulation and act as legal advisor to the president. It also has a role in improving the quality of new regulations and enjoys a *de facto* power to stop any regulations it considers as being of unsatisfactory quality. It has been instrumental in reducing duplication and overlap among regulations and enhancing the quality of law drafting. Given its crucial position at the end of the drafting process for major regulation, CJEF has improved the credibility of the regulatory reform policies by asking ministers to present regulatory impact statements (or a waiver issued by UDE) with each proposal. However, in the case of lower-level regulations not requiring the president's signature, the CJEF has no role.

Regulatory reform is reinforced by other bodies working on related structural reform policies. Since the early enactment of the policy, the ADAE has run in parallel to efforts to improve the Mexican public management services, in particular through a process of administrative modernisation and anti-corruption measures. Significantly, the Comptroller General was appointed vice president of the CDE. In practice, officials from the office of the Comptroller General participate in the review processes, concentrating on enforcement issues (*e.g.* inspections aspects) and on reducing excessive administrative discretion that may be a source of corruption. The office of the Comptroller General has also been responsible for monitoring the speedy and effective implementation of agreements reached with individual ministries. This auditing function has now been integrated with the Public Sector Modernisation Programme. The office of the Comptroller General has powers to sanction officials that do not comply with CDE decisions. According to the UDE, this threat has had important effects in the rapidity of establishing the review process and its "acceptance" by a large part of the ministries and agencies.[18]

Assessment: This complex of bodies strategically located at various points in the regulatory system compares well to mechanisms in other OECD countries to promote and sustain regulatory reform. As noted, under the leadership of the Ministry of Trade and Industry it has produced very rapid legislative and regulatory policy change. There has been considerable investment in specialised expertise in regulatory reform, in developing routine processes through which ministerial actions are more transparent and are independently overseen, and in establishing accountability and participation at high political levels. The developing co-ordination of legal, economic, and civil service auditing issues is very positive—and ahead of most countries—in exploiting the synergies between these related concerns and in producing a balanced and realistic programme.

Yet there are limits to the continued effectiveness of the current mechanism, justifying an examination of other strategies to carry the programme forward. The first is that the current structure places enormous strains on the Ministry of Trade and Industry as the primary body promoting reform in other ministries. The Ministry is a natural leader, due to the origin of regulatory reform in market openness and structural adjustment concerns. Yet the Ministry has no traditional management authority over other ministries, and hence its authority rests almost entirely on strong presidential support, backed up by its extensive contacts in the business community and its persuasive analysis. This can be an effective combination for a time, but is not a solid institutional basis for sustaining reform over the longer-term. Other OECD countries are locating regulatory reform mechanisms closer to the centre of government in order to exploit government-wide policy and management authorities and to improve co-ordination and consistency in reform efforts. Mexico, with its strong presidential system, offers a natural alternative to the Ministry of Trade and Industry for the next phase of reform.

A related problem is that the competition authority (CFC) and CJEF interventions and participation to the CDE are based on informal agreements. Thus, these arrangements can effectively be modified or abandoned at any time. This demonstrates a general informality in co-ordination arrangements. Notwithstanding the close working relations among officials in charge of structural policies, the ADAE does not refer to competition or trade openness. No official relationship or co-ordination mechanism is spelled out. Each policy is essentially developed and implemented by a separate ministry or agency. Disagreements among them are resolved at the Cabinet level. This may be a residue of the centralist tendencies formerly prevailing in the Mexican government. For instance, although, the competition authority has been invited to participate in the CDE since the beginning of 1999, its explicit advocacy powers on existing and future regulations, have not been co-ordinated with other structural reform mechanisms and institutions. In a similar way, although the Comptroller General (SECODAM) is the vice-president of the CDE and is legally responsible for ensuring the implementation and compliance of reform commitments to the CDE, co-ordination between public management reform and performances management of the public sector, and regulatory reform could be made more explicit. Consideration should be given to improving formal co-ordination procedures between these bodies.

A conspicuous absence is consumer protection policy. In part due to the fact that very few consumer groups exist in Mexico with the organisational skills and resources to participate, no formal or active mechanisms have been established to involve consumer NGOs, or even the consumer protection agency.. In addition, except for formal academic, labour, agrarian institutions and associations, no official device or transparent mechanism for involving any other non-governmental bodies in the CDE, other than through explicit invitations. This imbalance has probably reduced the appeal of the programme outside the business community, and limits the pace and scope of further reform.

2.3. Co-ordination between levels of government

The *1997 OECD Report* advises governments to encourage reform at all levels of government. This difficult task is increasingly important since regulatory responsibilities are shared among many levels of government: supranational, national, and subnational. High quality regulation at one level can be undermined or reversed by poor regulatory policies and practices at other levels, while, conversely, co-ordination can vastly expand the benefits of reform. Mexico regulatory reform policy clearly acknowledges this issue. The same day President Zedillo signed the ADAE in 1995, all state governors co-signed individual co-ordination agreements containing commitments to implement conceptually similar regulatory reform programmes. The only other federal country to carry out the same ambitious level of regulatory reform co-ordination among the states is Australia.

These non binding agreements have, in practice, formed the basis of a considerable programme of reform activity at sub-national levels in Mexico. This programme is important, as the extensive regulatory powers of the states and, in particular, the municipalities have considerable potential to frustrate changes at the federal level (see Table 1). Moreover, in the new federalist and co-operative environment the federal government has very few instruments with which to stimulate reforms at state and municipal levels, although the Federal Competition Law enables the competition authority to contest state laws and regulations that restrict free trade across the country. This capacity has in practice been used many occasion in the last few years by the CFC to take action against state barriers imposed by several governments on interstate trade in flowers, eggs and fresh meat, among others.[19]

Table 1. **Division of main regulatory powers**

Policy area/public service	Federal level	State level	Municipal level
National defence	x		
Foreign relations	x		
International trade	x		
Monetary policy	x		
Air transport	x		
Railway transport	x		
Post Office	x		
Domestic trade	x	x	
Redistribution	x	x	
Culture	x	x	
Industry and Agriculture	x	x	
Environment	x	x	x
Public transport	x	x	x
Education	x	x	x
Health care	x	x	x
Water	x	x	x
Urban planning		x	x
Housing	x	x	x
Staple Markets			x
Slaughterhouses			x
Waste disposal			x

Note: In the case of environment, this does not necessarily imply an overlapping regulatory jurisdiction, as the Federal Environmental Law (reformed in 1996 with the UDE support) clarifies the different levels of government who are in charge of regulating specific media (water, soil, air, toxic waste, etc.).

Source: Adapted from OECD (1998) *Decentralisation and Local Infrastructure in Mexico. A new Public Policy for Development*, p. 76.

Most of the regulatory problems deriving from relations with sub-national governments can be grouped into two broad categories.[20] First, many state and municipal rules overlap with federal regulations in specific sectors and activities, creating overlap, duplication and inconsistency. Many sub-national regulations also provide excessive discretion to regulators. Administrators issuing licences will often evaluate compliance against a mix of formal requirements and subjective criteria. The amount of time and resources and the unpredictability of the results that often accompany administrative and judicial appeals against an official's decision exacerbates the difficulties for SMEs. Moreover, a large number of permits and licences are justified as a substitute for local taxation. For instance, annual licences for bars and restaurants in some towns represent an important source of income for municipalities.

A second and important problem concerns regulations related to the provision of goods and services to the public by states and municipalities. Fiscal constraints of the past two decades have meant that a number of these services are provided by the private sector. However, many sub-national governments have had great difficulties in establishing and enforcing transparent and efficient regulatory frameworks to govern the provision of public goods and services, private concessions and government procurement. According to a recent study of the regulatory framework of a leading reforming state, *Aguascalientes*, important inefficiencies exist in at least three areas. First, complex and opaque cross-subsidies distort the pricing structures for public lighting, water and other public services. Second, important inadequacies exist in the terms of the concessions that have been signed by municipalities with private firms to attract investment in water treatment plants, urban water systems and solid waste management, among other services. Finally, problems have been found concerning local procurement

regulations where, in spite of the effort at the federal level, local laws still include discriminatory measures against foreign and even interstate suppliers not established in the state, and have weak dispute settlement provisions.[21] A co-ordinated effort—perhaps based on benchmarking criteria—in these topics should be launched to resolve these barriers to national economic growth and regional development.

These problems are exacerbated by short-term political considerations and the constitutional requirement that mayors cannot serve two three year terms in a row. A consequence of this situation has been that many technically and financially complex contracts are negotiated too rapidly, and contain medium term problems that require renegotiation by a new administration. This "political risk factor" is, of course, added to the costs of the installations and services.[22]

In part based on the co-operation agreements of 1995, the UDE, with the help of the CDE, has organised an activity to "provide support to regulatory reform programmes and state and local level". Two initiatives fall under this activity: first, efforts to convince states to establish the regulatory management tools developed at the federal level and, second, co-operative efforts to reform specific local regulations.

Table 2 shows that most states have instituted regulatory reform programmes and that 24 have signed agreements with their most economically prominent municipalities. Analysing results by state, it appears that the most important factor in determining local initiatives is more related to the political commitment of the administration in place rather than to the stage of economic development, geographic location or the political party in office.

Table 2. **States' efforts to improve the quality of the regulations**

Capacities and Initiatives	Number of states implementing
Co-ordination agreement between the Federation and the State	31
Co-ordination agreement between State and municipalities	25
Enactment of a State Policy framework (*Acuerdo Estatal*)	31
Establishment of a State Deregulation Council	31
Establishment of a State Deregulation Unit	25
Enactment of a state RIA	1
Programme of Regulatory Auditing	3
Programme to accelerated businesses start ups	3
Programme to improve inspection and enforcement systems	2
Programme to review new regulations	9
Programme to review existing formalities	31 and Federal District
Establishment of one-stop shops	31 and Federal District
Setting up of an Inventory of formalities	25

Source: Consejo Coordinador Empresarial, Direct communication with OECD, October 1998.

Another concrete initiative of UDE has been to provide technical support for the reform of local regulations. The most important example of this was the launching of an ambitious deregulation programme in the Federal District of Mexico City between 1995 and 1997.[23] In the old centralised system, the Chief of the Federal District was appointed directly by the president. In 1994, a constitutional reform gave to the Federal District a similar political, legal and administrative status than those of the 31 states. However, the change did not take effect until end 1997. During this transition period, the CDE/UDE and the appointed Chief of the Federal District launched an extensive programme to review all existing formalities and reform most of the local laws and regulations. In addition to improve the regulatory environment of the most important economic city of the country, the project also aimed to reduce the size of the informal sector (see Section 3.1.6) and serve as a model for other state and local governments. The results of these reforms are substantial in terms of the regulatory framework: nearly 40% of formalities

were eliminated, and 14 major regulations (local laws and *reglamentos*) were reviewed and modified. New regulatory frameworks were established in crucial policy areas like the environment, public transport, businesses inspection and a new permitting system was created which allows most new firms to commence business in less than seven days. The actual impact on businesses are yet to be assessed.

Although infrequently, some federal agencies have used direct incentives to foster reforms at the local level. For instance, *Fondo para la Vivienda* (FOVI), a federal state-owned trust which provides housing credits, facilitated access to larger credit lines to those states that undertook reforms of their civil and judicial proceedings laws in order to increase certainty of repayments and allow the securitisation of mortgages. To date these reforms have been passed by 16 states.

The UDE has also tried to tackle the co-ordination and compatibility problems between federal regulations and state and municipal regulations. Clarifications have been made in important laws like the environment law or the health law in the past few years. But these efforts may not be sufficient. Some local governments, using their constitutional rights, have started to establish regulations controlling their markets. For example, in 1989-1990 the federal government successfully deregulated road transport for both passengers and freight. However, as the reformed regulations apply only to federal highways, interest groups were able to lobby successfully for more restrictive licensing and safety regulations to apply to state and municipal roads. This has permitted the appearance in at least one state and in Mexico City of new and restrictive regulations which undercut the federal deregulatory initiatives as lorries and trucks may be obliged to load and unload when they change from a federal to a state road. As a pre-emptive measure, the federal government has sought individual agreements with each state permitting compatibility between state and federal transportation regulations. By mid-1999, three states had signed such agreements.

Changes in regulatory frameworks often do not indicate clearly the extent to which the actual regulatory environment for businesses and citizens has changed. There have been two recent attempts to measure directly and benchmark the regulatory environment in different Mexican states in recent times. In 1996, the *Instituto Tecnológico de Estudios Superiores de Monterrey*, a private university, published a comparative analysis of the investment friendliness of the states. The study included criteria such as the regulatory environment and the capacity of the judiciary to ensure an adequate rule of law. It stirred much attention and controversy but helped accelerate reforms. Candidates for state governorships are using its results in their election campaigns. A second benchmarking exercise published in March 1999 by the Mexican Business Council (CCE) compared the actual performance of regulatory environments across the 31 states, based on surveys of officials and businesses. For example the study benchmarks states in relation to the quality of their regulatory reform programmes, their efficiency in processing licenses and permits for zoning, construction, environment, water, etc. and the time needed to comply with them and will also look at the performance of local courts in dispute resolution (see http://www.cce.org.mx/).[24]

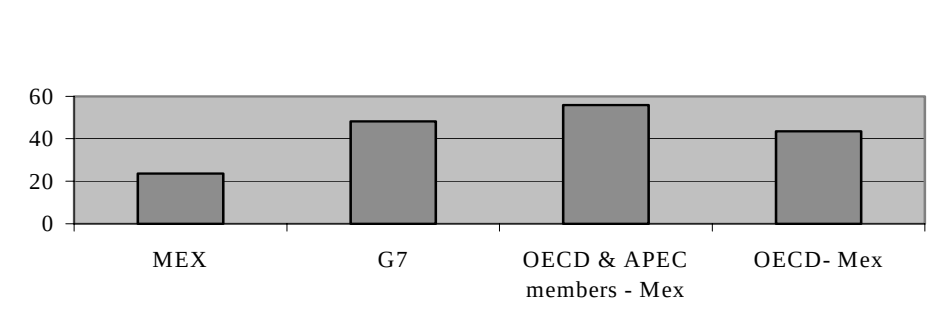
3. ADMINISTRATIVE CAPACITIES FOR MAKING NEW REGULATION OF HIGH QUALITY

3.1. Administrative transparency and predictability

Transparency of the regulatory system is essential to establishing a stable and accessible regulatory environment that promotes competition, trade, and investment, and helps ensure against undue influence by special interests. Just as important is the role of transparency in enforcing the legitimacy and fairness of regulatory processes. Transparency is a multi-faceted concept that is not easy to change in practice. It involves a wide range of issues, including standardised processes for making and changing regulations; consultation with interested parties; plain language in drafting; publication, codification, and other ways of making rules easy to find and understandable; and implementation and appeals processes that are predictable and consistent. The Mexican regulatory system has made progress in these areas, but important problems, in particular to reduce excessive discretionary powers and improve accountability, still exist.

Box 4. **Transparency of regulatory systems in selected OECD countries**

Based on self-assessment, this broad synthetic indicator is a relative measure of the openness of the regulation-making and regulatory review system. It ranks more highly national regulatory systems that provide for unrestricted public access to consultation processes, access to regulation through electronic and other publication requirements, access to RIAs, and participation in reviews of existing regulation. It also ranks more highly those programmes with forward planning of regulatory activities, a consultation system open to any member of the public, the publication of a consolidated registry of all subordinate regulations, the obligation of publicly release RIA documents for consultations. Mexico has a poor score on these criteria.



Source: Public Management Service, OECD.

3.1.1. Transparency of procedures: administrative procedure laws

The Mexican Constitution sets out general procedures to be followed in promulgating higher level regulations: *i.e.* laws and presidential rulings (*reglamentos*). The main element of this procedure is the requirement that proposed laws be signed by the president before being sent to Congress, in the case of laws, or published by the Federal Official Gazette in the case of *reglamentos*. This ensures a minimum degree of central oversight, co-ordination and accountability in respect of these higher level regulations. For lower level regulations, the Federal Public Administration Organisation Law *(Ley Orgánica de la Administración Pública Federal*), together with individual laws, gives broad powers to ministries and agencies to establish, to implement and to enforce regulations. Prior to the recent creation of the ADAE and the introduction of regulatory impact analysis for business regulations (see Section 2.1), these lower-level regulations were prepared without standard oversight or transparency procedures.

In the past few years, the degree of control exercised on administrative discretion has increased. Three important complementary initiatives to establish a formalised system for making new regulations are notable. The first is the introduction of a new and precise system for developing technical standards and process regulations, known in Mexico as *Normas Oficiales Mexicanas* (NOMs). The Federal Metrology and Standards Law of 1992 was designed to clearly establish the role and status of these instruments, thus reducing uncertainty and improving accountability. It sets out very detailed administrative procedures for drafting and publication of this type of mandatory regulation, which usually aims to control health, safety and environmental risks and provide consumer protection for products, services and processes sold or provided in Mexico. To harmonise and control the development of product and process standards, only nine ministries (out of 17) can issue NOMs. All NOMs must be drafted within one of the 22 national consultative committees (*comites consultivos nacionales de normalizacion*). Each committee is specialised in a regulatory area such as pesticides and risk related chemicals, health and safety at work, etc. The committees are chaired by the lead regulatory agency and are composed of government and private sector experts. Preparation of a NOM follows four steps: first, a ministry prepares a pre-project and presents it to a consultative committee. Since January 1998 the pre-project must be accompanied by a RIA and must also be presented to the UDE. Second, having obtained UDE and committee approval the ministry publishes the NOM proposal in the Federal Official Gazette and seeks comments. After a consultation period of 60 days, the ministry publishes, in the same gazette, an official response to any comment. Finally, not less than 15 days after this last publication, the ministry can publish the NOM in its final form. Two important additional procedures are a sunsetting every five years of all NOMs and provision for affected parties to comply with a NOM through an alternative deemed equivalent (these features are discussed further below).

A second improvement to the process of creating new regulation was the enactment in July 1994 of the Federal Administrative Procedure Law. This law established a set of principles and criteria for the interaction between authorities and citizens. Some of its main improvements related to regulatory procedures include:

– Clarification of the requirements for publication of all regulations in the Federal Official Gazette.

– Public access to information possessed by regulators.

– A clearer administrative appeal mechanism.

– Time limits for authorities to respond to a public request for information or authorisations.

– Minimum criteria to be followed by public officials during an inspection.

In December 1996, an amendment of the law established the regulatory impact analysis (RIA) process. As described below, this had a major impact on the process of writing new regulations (see Section 3.4).

Finally, the ADAE in November 1995 established a review process for all new regulatory proposals likely to have an impact on business activity. The mechanism has permitted review of more than 250 regulations (see Table 3). It was supplemented, for regulations that require the president's signature, by a second external review to be completed by the CJEF prior to the proposal being sent to Congress for approval or published in the Federal Official Gazette. The ADAE review programme has focused consistently on defining clearly the amount of discretion necessary in each step of a regulatory procedure: from granting a permit to completing an inspection.

Table 3. **Regulatory proposals received by the UDE, 1996-1998**

	Laws	Presidential regulations (*reglamentos*)	Decrees	Ministerial orders	Technical standards (NOMs)	Other	Total
1996	13	20	8	8	0	16	65
1997*	7	37	8	23	15	7	97
1998	3	13	16	17	102	44	195
1999 (Jan-June)	2	6	5	7	42	17	79

* Since September 1997, the ADAE individual reviews have been strengthen with the inclusion of the mandatory RIAs submitted to the UDE.
Source: UDE Direct communication, June 1999.

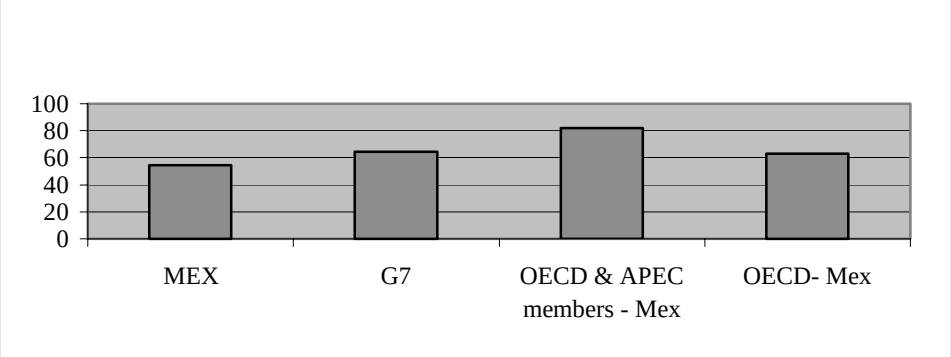
According to the UDE, the level of compliance with this new process has generally been high. During the initial implementation in 1995, the compliance stresses normally associated with establishing new requirements of this kind were overcome by the need for rapid regulatory responses in a number of areas to deal with the economic crisis following the 1994 peso devaluation. As in other countries, minor rules or politically sensitive regulations may still be implemented without review by the CDE/UDE. However, the strong support of the Comptroller General and political support at the highest level show potential to establish a new regulatory culture in Mexico.

The dual element of central oversight by the UDE and openness of the CDE have the potential to bring about substantial change. Evidence suggests that quality of new regulations has greatly improved. Reducing excessive regulatory discretion has been implemented as part of UDE systematic reviews of regulations. A key change has been the systematic elimination of the formerly widely used legal drafting technique of adding “among others” to any list of mandatory requirements or criteria.

However, some improvements would boost programme benefits. The scope of the UDE review of new regulations is too narrow. As indicated previously, the ADAE and the Administrative Procedures Law exempt important regulatory areas like public procurement and financial sector (unless they contain a business formality). A similar problem exists in regard to the preparation of technical rules and standards by ministries exempted from the Federal Metrology and Standards Law, for instance in the financial or telecommunication sectors. Another design issue is that a review mechanism based on a sequential analysis is not well adapted to dealing with important co-ordination and duplication issues arising either in relation to regulations enacted previously by the same ministry or those enacted by another ministry.

Box 5. **Critical approach in selected OECD countries**

Based on self-assessment, this broad synthetic indicator is a relative measure of the critical approach to government intervention and its nature. It ranks more highly national regulatory systems that provide the opportunity to affected parties to give views on the necessity of intervention, the use of precise threshold tests to justify action to be considered, and the inclusion in the RIA of benefit/cost principle and risk assessment requirements. Mexico ranks slightly below the G7 and OECD average on this score.



Source: Public Management Service, OECD.

3.1.2. Transparency in implementation of regulation: forward planning of regulatory actions

A number of OECD countries have established mechanisms for publishing details of the regulation they plan to prepare in future. The objective of this forward planning is to foster the participation of interest parties as early as possible in the regulatory process and, to some extent, to reduce transition costs through giving more extended notice of forthcoming regulation.

Two recent Mexican initiatives are worth noting on this respect. The 1992 Federal Metrology and Standards Law mandates that the National Standards Office (*Direccion General de Normas*) publish annually in the Federal Official Gazette a list of all technical standards to be considered during the coming year by each of the 22 consultative committees. The list includes, for each committee, the name, address and telephone number of its president, who is responsible for disseminating information and organising the activities of the committee. The time frame for the consideration of each proposed standard must be indicated to give all participants and the general public an idea of when the corresponding technical standard might be issued, and to provide early opportunities for public input.

In a more informal way, the UDE has started to implement a system of forward planning of regulatory activities. At each CDE Executive commission meeting, the UDE submits an updated list of proposals to be reviewed or under review to the business and social sector representatives in attendance. The main objective of this is to call for interested parties to participate in the *ad hoc* advisory groups in charge of preparing the reform proposals. Since October 1998 the list has been made publicly available on the CDE Internet homepage; upon request, the UDE then provides the complete texts and regulatory impact statements for all regulatory proposals under review to any interested parties.

The National Standards Office is sceptical about the results of publishing the annual list of NOMs to be prepared. It has argued that the published plans of most consultative committees are too imprecise to stimulate interest in the process among potential new participants. This may reflect a deliberate lack of openness on the part of committees, but experience suggests that some time is needed before new opportunities for public consultation are accepted. Active encouragement of participation from government bodies can help speed the process of familiarisation.

3.1.3 Transparency as dialogue with affected groups: use of public consultation

Mexico does not have a comprehensive law or government policy requiring the use of consultation in making, modifying or repealing legislation and regulation. However, laws and government policies requiring consultation exist in some areas and a wide variety of forms of consultation are used to some extent (including notice and comment, circulation for comment, information consultation, advisory groups and public hearings).

Formal procedures to ensure public consultation have been limited. The Federal Administrative Procedure Law does not establish a specific, mandatory mechanism for citizen participation in the rule-making activities of the federal government. The Law does contain minimal recognition of public consultation procedures. While leaving the issue of when consultation is to be undertaken to be determined in sector specific laws, it requires that, if a law establishes a "notice and comment" mechanism, the period of time allowed should not be less than 60 days. Other than that minor limitation, the consultation process is largely at the discretion of the ministry or agency preparing the regulation, unless constrained by provisions of a specific law. In practice, informal consultations occur most of the time and at all stages of the process—both before and after the formulation of policy proposals and later when the detailed draft regulation is ready. Generally a ministry submits the draft to selected representatives of interested parties to receive comments and suggestions. Negotiation meetings are sometimes organised for major reforms.[25]

Important initiatives have recently been taken. The public consultation procedure stipulated by the Federal Metrology and Standards Law, described in Section 3.1.3, is the most detailed in Mexican law. A 60 day period for receiving comments follows publication of the project in the Federal Official Gazette. After that period, the National Standards Office must publish its response at least 15 days before issuing the final version in the Federal Official Gazette.

The participation of businesses, and in some respect, of other interested parties at the CDE also improved the openness of the process of making new regulation. The dozen or more *ad hoc* consultation groups organised under its umbrella to review existing formalities and new regulations have had an important impact on improving consultation. These groups have been successful in improving the quality of draft regulations and the business community has welcomed them as an important advance.

Some specific laws have established particular consultation processes:

- The Law on Foreign Trade demands that any proposed regulation which may have impacts on international trade should be submitted for comments to the Commission of External Trade (*Comision de Comercio Exterior*—COCEX).

- The general environmental protection law states that the Environment Ministry must convene *consultative commissions* to receive comments from government agencies, academic institutions, and social and business organisations on the design and evaluation of environmental policy. On creating new regulation, the Environment Ministry must state the reasons for accepting or rejecting opinions presented by the commissions. The Ministry must also consult with the public during the evaluation of applications for environmental permits, which includes making environmental impact statements (EIAs) public and assuring that the public right to make observations and propose changes to EIAs has been respected.

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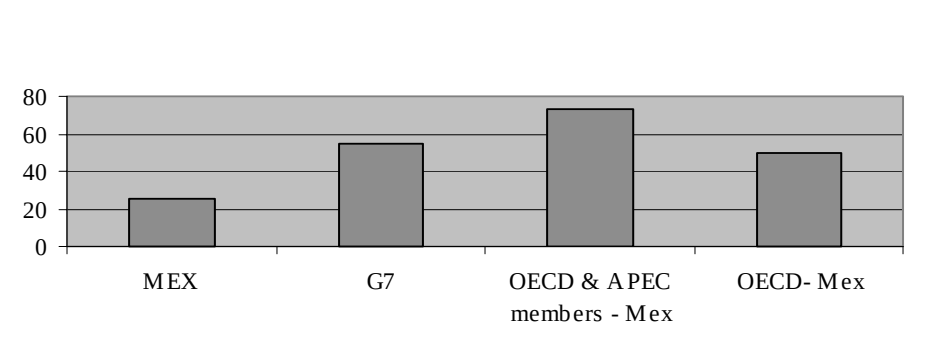
– Another type of consultation procedure applies in the case of regulation of the natural gas sector. The major implementing rules stipulate that any directives proposed by the Energy Regulatory Commission must be published for public comment at least ninety days before the final publication.

Assessment of public consultation. Together, these separate steps represent solid but incremental changes toward opening up the decision-making process for regulations. In that sense, Mexican initiatives are consistent with the international trend towards more transparent and accessible regulatory processes. However, important gaps continue in Mexican consultation processes. This gap is due to the absence of a generally applicable consultation requirement for higher-level laws. An extension of the "notice and comment" system applied to NOMs to these laws (with necessary adjustments) would be an important step forward. Many OECD countries have found that notice and comment mechanisms of this kind are a minimum guarantee of regulatory transparency.

Second, as noted above in relation to publication of prospective NOMs, international experience indicates "notice and comment" should be supplemented by active mechanisms to encourage participation of a wide range of interests, particularly when a participative tradition to regulatory decision-making has yet to take root. Mexico has been quite successful in increasing participation by targeting certain groups. However, it will be important to scrutinise the diversity of participation on regulatory issues, in order to avoid capture of the process and the regulators by narrowly based interest groups.

Box 6. **Use of public consultation in selected OECD countries**

In this synthetic indicator of the scope and systematic use of public consultation, Mexico is under the OECD average score. This indicator looks at several broad aspects of the use of consultation and ranks more highly those that are routine, non-discretionary, accessible to all interested parties, and used earlier in decision processes. Despite the increasing use of public consultation in Mexico, its consultation programme is used in some cases, is less open to all interested parties, and gives regulators more discretion about when and how to consult, potentially reducing transparency and raising the risk of capture by special interests.



Source: Public Management Service, OECD.

3.1.4. Transparency in implementation of regulation: law drafting

Legal clarity is essential to good regulation. If rules and regulations are poorly written or unnecessarily complex in structure, problems will arise during implementation and enforcement. Unclear or unspecified legal terminology can lead to major compliance problems. As in several aspects of the transparency of its legal system, Mexican experience in this respect shows a mixed pattern.

Law drafting responsibilities accrue in the first instance to a specialist unit in each ministry or agency in charge of preparing proposed regulations. Prior to the establishment of the ADAE regulatory review programme there was little external review of the regulation produced by the individual agency. The only exception was the requirement for higher level regulations to be signed by the president. In practice, this involved scrutiny by the president's legal office. This system had limited success in ensuring regulatory quality. Imprecision and the use of obscure legal terms were relatively common. Laws were written to be deciphered by lawyers or other specialists, rather than to be intelligible to laymen.

Lawdrafting has not been regarded as part of the regulatory reform programme in Mexico. However, the CDE/UDE and the CJEF have progressively added quality assurance filters. For instance, as part of the CDE review, UDE's internal lawyers and external legal service providers have established minimum criteria for legal quality of regulations. Perhaps the key issue addressed during these legal analyses is verification of the legal standing of the regulation. In the past, many ministries and agencies have tended to extend, unilaterally, their statutory powers by making unanticipated uses of broad powers delegated to them to make lower level rules. By applying a simple check of the authorising law, the UDE has eliminated many such abuses of discretion.

A second key change has occurred at the end of the economic and technical review, where a more detailed and in depth study is now undertaken. At this stage the focus is on the structure and clarity of the text to ensure understandability and compatibility with existing regulation. This check is repeated by the CJEF, the body ultimately responsible for the legal quality of legislative proposals and major implementing rules. However, these new processes do not proceed from clear and formal principles and guidelines and, to this extent, can be difficult for individual agencies to anticipate. No policy on "plain language" has been established to improve simplicity and clarity of regulations. Moreover, as in other key parts of Mexico's reform initiative, no training programmes have been developed.

3.1.5. Transparency in implementation of regulation: communication, compliance and enforcement

Communicating regulations

Complex and unclear regulation, and difficulties at the judicial level with interpretation and enforcement, have meant that Mexican regulation has long been the source of considerable uncertainty and confusion to citizens. Aware of the negative impact of this situation on achievement of regulatory objectives, federal and state governments have launched programmes to improve the communication and enforcement of regulation. In the early 1990's, the Comptroller General launched a government-wide programme to establish definitively the status and content of all formalities. After laborious effort, a first inventory of formalities and services was established in 1994. Its impact was, however, reduced by problems as to its completeness and by difficulties of access to its information (it was published in two or three dozen binders). Moreover, the information soon became obsolete after the restructuring of the ministries in 1994. This effort was most important as a learning process which contributed to the implementation of a subsequent programme, undertaken by UDE as one of its first tasks, to complete and update an inventory of formalities. In 1996, a new inventory was prepared and published on the Internet, including more than 2 400 business formalities applied by federal authorities, and became the dataset of existing formalities to be reviewed (see Section 4). In 1998, this Internet inventory of formalities was completed by the addition of the official list of standards (NOMs) and a compendium of all current laws and other major legal regulatory instruments. The same year, a free telephone service to access information in these inventories was established. Similar approaches are now being pursued in states and municipalities. Leapfrogging the printing press, creative initiatives based on the Internet have enhanced

communication and information about the regulatory framework. Recently, private entities have also begun to produce lists of regulations on the Internet, with search capacities and other value-adding devices.

Efforts have also been made to improve the public's awareness of its rights and of the obligations of inspectors (see below). In 1993 the Comptroller General launched a open access phone-based service (SACTEL) to enable complaints to be made against public servants and to provide information on federal and administrative procedures and formalities. A second, more ambitious, project concerns the reform of the Mexico City business inspections system (see Section 2.3). In a joint initiative of the previous government of the Federal District and the CDE/UDE a phone service was created to permit businesses to check the validity of inspections by telephone (LOCATEL). Only inspections confirmed by phone could be carried out. This system was developed as a fight against excessive discretion from enforcers and the existence of "pirate inspectors" trying to extort payments from small businesses.

Box 7. **On-line search of business formalities**

In June 1998, the UDE launched an ambitious communications project: an electronic one-stop shop based on the inventory of formalities supported by Internet search capacities. Based on the six digit ISIC definition of activities, a user-friendly on-line search tool available on the CDE web page (www.cde.gob.mx) permits any person to retrieve a list of formalities needed to start up or operate his business. With the transformation of the inventory into the official federal registry, these lists will provide near 100% accuracy and legal security (see Section 4 on the establishment of the federal registry).

The procedure includes three steps:

1. The applicant defines the economic activity from the ISIC catalogue. If the person does not know the six digit number, a key word search engine or a progressive narrowing down from division, group, class and activity helps him to fix it.

2. The search is further narrowed when the system asks two additional attributes: (a) the type of administrative procedures corresponding to the business development: *e.g.* constitution of the business, start up the activity, operation, export or import or closure of the business, and (b) boundaries to the search by specifying the type of formality, either voluntary or mandatory.

3. A list of formalities is then presented, specifying the agency or Ministry in charge of administer it.

By clicking into the formality code, the system links directly to the official Inventory. At this point a standard format describes the selected formality. The following details are included: the place to present it, the agency in charge of responding, all the information requirements (together with attachments), the time the agencies have to respond (along with the existence of an automatic approval after that date), the fees and charges needed to apply it and additional comments.

Enforcing regulations

The enforcement of regulations is problematic in Mexico. Traditionally, a law or a subordinate regulation was a vehicle to set down a policy as well as to establish rights and duties.[26] In general, enforcement policy was delegated to lower levels. This created stresses on low level administrative units without adequate resources. A related problem was the excessive discretion allowed to regulators to implement enforcement strategies. Finally, the situation was aggravated by serious inefficiencies in the judicial system. These three issues, though connected, are analysed separately.

A major concern driving regulatory reform since the beginning has been that enforcement deficiencies create corruption opportunities for businesses and civil servants, with a disproportionate impact on SMEs. Mexico is rare among OECD countries in specifically including in the regulatory review policy a test of whether regulations are backed with sufficient budgetary and administrative resources to ensure their effective administration and enforcement. Based on these considerations the federal government has in recent years tried to re-invent the inspection and enforcement aspects of its regulatory systems.

Two approaches have been used. First, the UDE has promoted the use of third party certification of compliance with technical standards. Through this system, regulators can concentrate on controlling only the third party entities, significantly reducing the budget costs of inspections. In general, the participation of the private and social sector (*e.g.* universities) has resulted in efficiencies which have reduced time and paperwork for businesses. This technique is used, for example, to check car pollution emissions in some cities including Mexico City, in sanitary licenses, environment audits, authorisation for forestry programmes, granting mining concessions, etc.

A second approach is re-engineering of inspection systems, replacing *ex ante* controls with *ex post* notification and random checking. Two examples of this approach are the customs administration of the Ministry of Finance and the licences and permits area of the Ministry of Health.

The customs administration was the first to introduce random inspections of arriving passengers and importers. Its objectives were, in part, to fight against smuggling and corruption and in part to speed processing times at the borders. Passengers or importers in the custom premises push a button, leading a red or green light to appear randomly. Those who receive a red light are inspected (see Box 5 in background report to Chapter 4).

A similar approach was applied successfully in the Ministry of Health, where the system of sanitary licenses has been completely overhauled. Before the reform, sanitary licenses were among the most restrictive and costly regulations. Most businesses had to be inspected prior to receiving a sanitary licence.[27] In practice, this created a large backlog of inspections that delayed business openings and provided incentives for non-compliance with the law. Reforms to this system eliminated low risk activities from sanitary controls and allowed businesses in some activities to simply notify the Health Ministry of operations. These businesses are randomly inspected to ensure compliance. The reduced number of "high risk" activities must still undergo *ex ante* inspection. Sanitary controls are required solely in cases where there is a clear danger to the final consumer. The authorisation of some sanitary licenses is further hastened when the solicitor presents a registered third party certification. This greatly reduced controls: 92 of 297 previously regulated activities were exempted from sanitary controls. The number of activities requiring a sanitary license was reduced by 81%, and are now limited to chemical, pharmaceutical and medical products and services. The result is that over 450 000 firms are benefiting from more flexible sanitary controls.

The Comptroller General, in parallel efforts, has also undertaken innovative programmes to improve ethics and fight corruption in the public sector. Its main tools have been auditing, investigation of corruption and misallocation of resources, establishment of precise standards for public auctions, public contracts and other monetary transactions involving public servants, and introduction of an array of reporting requirements and controlling mechanisms. They have also established a large programme of "sleuth users" as a random checking mechanism. This involves the Comptroller General employees applying for a range of licences and evaluating the authorities' responses.[28]

The informal sector is a daunting challenge to improving regulatory compliance. By definition, informality is the condition of non-compliance with a given set of standards and regulations, like prohibitions, inspection requirements, zoning laws, labour legislation, and tax regimes.[29]

As in many emerging economies, the Mexican informal sector is quite large. According to the World Bank, 41% of the work force in major cities is employed on this sector. In the 1980s and 1990s its size increased.[30] Domestic services and retail trade, and to a lesser extent construction, have been the typical activities where informality has developed. A very large majority is formed of micro-firms between one and five employees that rely on family ties for labour. They often operate without accounts and premises, producing low quality/low costs products and services. Transactions typically take place on the street in family stores or in kiosks.[31]

Many factors have fuelled the growth of the informal sector: demographic pressures, migration linked to rural exodus to urban cities, education, and, of course, the series of economic crisis that hit Mexico in the past two decades. Rationalisation linked to increased international competition and other structural reforms have also contributed in the short term.[32] Exposed to rapid and strong internal and external competition, some large, medium-sized or "formal" firms have temporarily used the informal sector as a way to downsize sub-contracting semi-finished goods or distribution with informal firms.[33] In many ways, the informal sector has functioned like a spontaneous safety net, in which poor families seek refuge from the effects of protracted growth, inflation and low wages, waiting for conditions to improve.

Growth of the informal sector is also due to problems in the regulatory framework. The design, administration, and cumulative effects of regulations create strong incentives for total or partial evasion. Regulations, even if justified, can have negative impacts on small firms. The well known regressive effect of regulations relative to firm size means that compliance costs are disproportionately higher for small firms. The nature of regulations used in Mexico further increases compliance costs. Many of the regulations relevant to the informal sector are administrative, mostly carried out through *ex ante* formalities such as registries, licences, fees, contracts with public authorities, zoning authorisations, and other regulations affecting start-up. The costs of this market entry paperwork in terms of time and money can be difficult for the hurried entrepreneur. For instance, in Mexico the cost of legal entry were estimated in the early 1990s at 83 to 240 days, and represented an expenditure of $210 to $368.[34] "Variable regulatory costs" present another problem. The flexible, changeable and mobile nature of many informal operations make it difficult for micro-firms to comply adequately with regulations based on the number of employees or revenues (such as regulations implementing tax, labour and social security legislation). As a result, informal firms develop a regulatory strategy where they reduce (or eliminate) compliance costs enforced by the government, while paying more flexible "evasion costs" such as bribes to official inspectors, or protection fees to vigilantes, gangsters and other non-official authorities who impose their own regulation in whole neighbourhoods, stretches of sidewalks, lines of business, etc.[35]

A second disincentive to comply concerns legal security problems and the related social and cultural environment. Compared to a distant and sluggish government and its deficient welfare system, a micro firm receives prompt services, support and protection in the non-official social and economic environment where it operates. This reduces further the private and social benefits of "official" regulations.

Additionally, some regulations pose direct problems to micro-firms. For instance, interest groups can capture regulatory authorities to set up entry barriers to smaller competitors. This was the case until 1992 in the federal road freight transport sector. Harder to detect, particular regulations or policies have also important side effects with a strong impact against micro-firms. For instance, a perverse effect of governmental anti-inflationary policies used until recently, such as price controls of basic goods like bread, tortillas and essential groceries was that they severely limited the earnings of informal commercial kiosks (and therefore had a regressive dimension).[36]

Progressively these effects feed on themselves creating a vicious circle. The informal sector has little incentive to pay taxes or social security contributions as they are excluded from many government expenditures, entitlements and subsidised services set up since the 1950s, like vacation, household

subsidies, housing credit, export support, etc. But at the same time it "unfairly" competes with the "formal" SMEs, obliging the latter to switch to "evasion strategies". This reduces further the tax base, which reduces the government's budget for improving a more adapted enforcement mechanism or for establishing programmes to help this sector. At the end of the day, the existence of such a high level of non-compliance has a corrosive effect on the rule of law, creating a pervasive culture of non compliance.

However, it is important to note that being informal does not mean that a micro-firm is privileged in its cost structure compared to a formal firm. A team from the World Bank calculated that in Mexico "regulatory costs" (including compliance and evasion costs) correspond to approximately 24% of total costs of informal firms. For repair and other services, these costs fluctuate between 50 and 63% of total cost.[37] With such "regulatory costs," these micro-firms are trapped in informality since their capacity to grow is bleak.

Since the mid-1980s, Mexican officials have taken measures to reduce the informal sector to achieve a more balanced and equitable economic society, to fight corruption, and to encourage entrepreneurial energies. During the Salinas administration, the Ministries of Labour, Commerce and Industry, Finance, Social Development, development banks, like *Nacional Financiera*, NGOs and local entities launched an array of measures targeted at these firms. Key components of such strategies were the provision of finance, technical assistance, promotion of inter firm organisation and administrative simplification. For instance, tax reforms in the late 1980s were intended to help small firms by lowering tax rates and reducing paperwork. In 1987, Congress enacted a law that created the concept of "*Ventanillas Unicas de Gestion*", literally the "only window for management". Since then, dozens of one-stop-shops have been set up to provide information, and in some cases administer, over 70 formalities ranging from sanitary licences and notification to tax registration and social security registration.

However, despite partial successes, these initiatives did not reduce the growth of the informal sector or improve their chances to become "formal" businesses. In part, this is due to poor economic performance, but also most of the programmes were unco-ordinated and dependent on expensive "facilitators" making them extremely costly to sustain.

Since 1995, the government has tried a complementary approach to "re-legalise" the informal sector. Its main component was to reduce regulatory compliance costs, either their official components, their "evasion costs", or both. An important government response was the deregulation programme launched in Mexico City in 1996 (see Section 2.3). To reduce official compliance costs, a new licensing system was set up in which 73% of activities (which created 78% of the added value in Mexico City) were deemed "low risk" and could comply with land use, fire prevention, construction and pollution control requirements through a single format. An automatic authorisation was established after seven days if regulators had not commented. In parallel, these efforts were completed by deregulation of federal formalities in important sectors such as sanitation, environment, taxes, and social security (see Section 4).

To reduce "regulatory evasion costs", three strategies were used. First, the government declared a general pardon for businesses out of compliance. This amnesty permitted more than 10 000 micro-firms to "formalise" tax or other regulatory situations without paying arrears or fines. Second, in order to combat discretionary abuses by inspectors and private "vigilantes" as well as to grant legal security to businesses, Federal District authorities and the Mexican Business Council (CCE) launched in 1997 a certification programme where after a simple audit a business premise was recognised as "in compliance" with local regulations and a corresponding official document delivered. Third, UDE together with the Comptroller General and Federal District authorities developed a verification system where inspectors and business were chosen at random and where different transparency rules were created to reduce abuses and harassment during enforcement.

It is too early to assess the results of these measures. As indicated above, the roots of informality go beyond the regulatory framework, and complete deregulation would not solve the excess supply of unskilled labour or the scarcity of capital and education supporting the informal sector. However, Mexico's initiatives are worth noting, as they recognise the explicit link between regulatory reform, non-compliance and the need to help micro-firms to grow.

Reform of the judicial branch

Enforcement and compliance are, of course, highly dependent on the rule of law prevailing in the country. As indicated in Section 1, the centralist and authoritarian administrative environment, in place until recently, resulted in a judicial branch that was politicised, weak and inadequate. In addition to their lack of real autonomy, courts and judicial bodies were constantly underfunded. This made the pace of justice extremely slow. Years were needed before a dispute could be settled. Lack of resources also created vast opportunities for corruption and abuses among civil servants employed in the judicial branch. Dearth of training and career development programmes bled the tribunals.[38]

As a result, access to justice was often achieved through different means. First and foremost, the writ of *Amparo* permitted any citizen to appeal to the Supreme Court and to the other courts affiliated to the federal judicial system. The *Amparo* is a mechanism through which citizens can challenge any infringement by the government of individual rights granted by the constitution.[39] This specific *habeas corpus* enabled many citizens and businesses to successfully oppose and even repeal flawed rules or improper actions by the administration. As such, the *Amparo* also serves as an *ex ante* control to verify the quality of regulations as regulators writing regulations are deterred by possible challenge in court by any person or business.[40]

A second mechanism used by the Mexican government to improve access to justice was the progressive creation of an array of partially independent quasi-judicial bodies within the administration. From the early 1930s the government established administrative tribunals and entities in the field of labour disputes (*Junta Federal de Conciliacion y Arbitraje*) agrarian affairs (*Tribunal Agrario*), electoral controversies (*Tribunal de lo Contencioso Electoral Federal*), fiscal matters (*Tribunal Fiscal de la Federacion*), and other administrative dispute settlement (*Tribunal del Contencioso Administrativo*). It should be noted that in 1992 and 1996, respectively, the agrarian and electoral tribunals were incorporated in the judicial branch and a totally independent *Instituto Federal Electoral* has now been created.

There is no doubt that the *Amparo* mechanism and the quasi-judicial tribunals solved many problems and speeded settlements. However, for most private citizens and firms they did not provide an adequate solution. Resources and time were still needed to win or to avoid reprisals. As public participation increased, the demand for a fairer and more efficient system prevailed.

This became a major policy of the Zedillo administration. In the days after coming into power in December 1994, the president submitted a legal package of major constitutional and legal changes, which has since been enacted as the Judicial Reform. They were part of a policy explained a few months later in the 1995 -2000 National Development Plan:

> *Today, our legal and institutional framework is not totally adequate to the expectations and conditions of our time. Important backwardness, vices and needs on public security, prosecution and delivery of justice, combat on corruption and impunity, legal certainty and acknowledgement of fundamental rights, particularly of most vulnerable of social groups subsist. Consequently, many members of our national community have legitimate doubts and concerns about the enforcement and reality of the State of Rule, and for equality in front of the Law and public institutions*.[41]

The president's reforms endeavoured to expand the constitutional power of the federal judiciary overhauling the composition of the Supreme Court to make it more accountable for its jurisprudence and less vulnerable to pressure from executive and legislative branches.[42] The main characteristics of the reforms are the following:

- Restructuring and renewing the Supreme Court to strengthen the federal judiciary (number of Supreme Court Ministers reduced from 26 to 11; term limits increased from six years (which use to coincided with the presidential term) to 15 years; nominations, which will be staggered and scheduled to avoid overlapping with transition in the executive branch, made subject to public congressional hearings and approval by two thirds of the Senate; and the freeing of the Supreme Court from administrative duties relating to the federal judiciary).

- Creating the Federal Judicial Council (*Consejo de la Judicatura Federal*), now in charge of managing and modernising the federal judiciary system, including the selection, promotion, policing and general improvement of the quality of federal judges and magistrates (the Council is comprised of the President of the Supreme Court, three members elected by judges and magistrates, two designated by the Senate and one by the president of the Republic).

- Enabling federal and state legislators and the Attorney General to contest the constitutionality of laws before the Supreme Court, whose decision becomes broadly applicable to all citizens (in contrast, when a person wins an *Amparo* trial, the law in question only ceases to apply to that person in particular).

- Granting municipalities access to the Supreme Court for the settlement of disputes with other municipalities, states, or the federation (only the states and the federation had such access before), and clarifying the basic principles for the judicial procedures that apply to jurisdictional disputes of all types.

The efforts of the CJEF and the UDE also contributed to streamlining court procedures. In May 1996, reforms were implemented to facilitate the resolution of business disputes and to provide businesses with greater access to loans by eliminating the requirement that guarantee trusts (*fideicomisos de pago*) be administered by third parties. According the *Tribunal Superior de Justicia del Distrito Federal*, the reforms reduced the number of trials in Mexico City by 41% between 1995 and 1997.[43] Similar reforms were passed in the northern state of Nuevo León in 1997, resulting in a 52% reduction in the number of trials between 1996 and 1998. Because it is now more difficult to unscrupulously delay trial proceedings, many more commercial disputes are now being resolved without going to court.

These changes helped to strengthen judicial oversight of administrative discretion. Yet Mexico is still in a transition phase, where new mechanisms co-exist, sometimes uncomfortably, with older ones. Improvements and legal reforms are still needed. The most challenging task will be to gain the confidence of citizens through concrete results. This will only be achieved through a continuous effort to deepen and strengthen the professionalism, technical skills and specialist knowledge of the courts and their officers. Reforms of this kind involve the building of new cultures and institutions and are inherently long-term in nature.

3.2. Choice of policy instruments: regulation and alternatives

A core administrative capacity for good regulation is the ability to choose the most efficient and effective policy tool, whether regulatory or non-regulatory. The range of policy tools and their uses is expanding as experimentation occurs, learning is diffused, and understanding of markets increases. At the

same time, administrators often face risks in using relatively untried tools. Bureaucracies are highly conservative and there are typically strong disincentives for public servants to be innovative. A clear leading role—supportive of innovation and policy learning—must be taken by reform authorities if alternatives to traditional regulation are to make serious headway in the policy system.

The use of alternatives to traditional regulation is fairly new in Mexico's regulatory processes. Until the middle of the 1990's most regulations were based on the "command and control" principle. Mexican regulators and enforcers often focused on compliance with rules and procedures rather than results. More recently, some reforms have been launched. In 1994, the Environment and Energy Ministries attempted to introduce a market for SOx pollution permits in the main industrial zones. However, concerns raised by publicly owned enterprises in the oil and electricity sectors and poor design of the scheme compromised this effort. In 1995, ADAE established an explicit review criterion which required agencies to ensure that "... no regulatory alternatives exist that can accomplish the same objectives at lower cost". This test was subsequently reinforced by a special section in the RIA reporting system. Based on these tools, and through negotiations with regulators, the government has been designing regulations providing more information to consumers, using random ex post compliance verification schemes, seeking implementation of voluntary rather than compulsory standards (self-regulation or co-regulation), providing flexibility in regulatory compliance, regulating ends rather than means, eliminating underlying economic distortions, and using insurance schemes. It is too early to judge their final impact but some examples can illustrate the scope of current efforts.

As in many OECD countries, most innovations have concentrated in the area of environmental protection. Mexico receives mixed marks here. The positive steps include:

– The Ministry of Environment was the first ministry to enact, in its reformed law of 1996, the use of the "equivalent principle" to prepare technical standards (NOMs). The objective is to allow any business to propose more efficient compliance mechanisms that achieve equal or superior performance to that achieved via NOM. Approval of a business' proposed alternative requires that it be presented in detailed form to the National Office of Standards, who, after advice from an appropriate committee, issues a certificate of conformity or rejects the proposal. Automatic approval is granted if the application receives no response after a set time. Approvals are announced in the Federal Official Gazette. This last feature is intended to grant the same benefits to other parties by alerting them to the existence of an approved alternative compliance mechanism. To date, this process has been used for NOMs in three policy areas: fisheries control, health and safety, and environment. In the latter area, a group of businesses proposed an alternative to a NOM controlling the size of the mandatory buffer zone surrounding explosive vessels and installations with risk. The accepted alternative consisted of a smaller buffer zone protected by special installations and devices.

– Environmental enforcement has used as an alternative to traditional enforcement approaches a programme of eco-audits. These audits are in-depth and interdisciplinary reviews of a company's production process to identify pollution and risk conditions. The audits cover discharges into all media (including water) and determine the degree of compliance with regulations and international engineering practices. Following the audit, the company signs an agreement with the authority on the steps to clean up its operations, committing itself to specific timelines. By agreeing, the firm avoids criminal sanctions and can often reduce its insurance premiums. By August 1997 the Environment Ministry had approved 2110 audits (775 in border states with the US) and 698 had been completed (198 in border states).[44]

On the other hand, the record of Mexico is poor with respect to the use of economic instruments, particularly in the area of managing externalities (for instance, linked to environment, water and fisheries management). Only two schemes are reported: water effluent charges and transferable hunting rights. But as mentioned in the previous section, the UDE also made a major effort in finding alternatives to permitting and enforcement systems and has promoted economic instruments like transferable permits, concession auctioning, etc in areas such as federal transport and bidding schemes for mines and spectrum franchises. In particular, a significant number of *ex ante* permits and licences have been replaced with general rules (often performance based) and *ex post* checking.

Efforts to adopt innovative alternatives have been too recent to allow for a definitive evaluation of their impact. A major gap in efforts to date is the lack of progress in establishing economic regulatory instruments for social and environmental regulations. Some significant initiatives have been taken, even if overall Mexico is trailing other OECD countries in this field. Of particular interest to other OECD countries is the innovative use of the equivalence principle in relation to NOMs, an approach that is currently being considered in Australia. If it performs well while satisfying transparency and accountability standards, this would be a promising and powerful tool to expand the use of performance oriented regulations. The Mexican implementation seems to be the first broad use in practice of this mechanism, and should be monitored.

3.3. Understanding regulatory effects: the use of Regulatory Impact Analysis (RIA)

The 1995 Recommendation of the Council of the OECD on *Improving the Quality of Government Regulation* emphasised the role of RIA in systematically ensuring that the most efficient and effective policy options are chosen. The 1997 OECD Report on Regulatory Reform recommended that governments integrate regulatory impact analysis into the development, review, and reform of regulations. A list of RIA best practices is discussed in detail in *Regulatory Impact Analysis: Best Practices in OECD Countries*[45] and provide a framework for the following description and assessment of RIA practice in Mexico.

With the 1996 amendments to the Federal Administrative Procedure Law, Mexico joined the two thirds of OECD countries using RIA as a tool to improve the quality of regulation, and the small group of countries where such a requirement is established by law. The law states that all draft regulations with a potential impact on business activity must be submitted to UDE for review, along with a regulatory impact statement (RIA). As in other countries, development of RIA in Mexico has not been entirely smooth. The benefit-cost analysis (BCA) requirement for preparation of NOMs that was established in 1992 encountered major implementation problems. Consultative committees in charge of preparing the BCA had great difficulties in producing scientific or objective data. BCA was often little more than a list of qualitative benefits and political considerations set against a description of minor transition costs. In effect, BCA became an extra layer in the paperwork process, rather than a guide to decision-making.

Between the establishment of the ADAE (January 1996) and the effective establishment of RIA requirements (January 1998), the UDE and regulators gained valuable experience, based sometimes on frictions and problems between agencies. At the beginning, the regulatory review occurred at the very end of the drafting process. Regulatory agencies were not accustomed to having their proposals reviewed by a third party, and did not allocate sufficient time to incorporate comments. The review process was characterised by regulators as a bottleneck that impeded important regulations, and even regulatory reforms. The review process was undermined by confrontation and lengthy and sometimes sterile negotiations. Analysis of these problems and a six month pilot phase has resulted in a fairly successful launch of the new RIA programme. To correct earlier problems, the programme is designed to enhance

communication between the UDE and ministries/regulatory agencies and to provide incentives for incorporating quality regulation criteria earlier in the drafting process to avoid "unpleasant surprises" for the ministries at a later stage.

UDE's current RIA requirements were developed from a study of international best practices. The objectives are to provide CDE/UDE with more detailed information on the benefits and costs of regulations and to help regulatory agencies to consider ADAE criteria early in the regulatory process. The ultimate goal is to foster a cultural change among regulators.

A major element of this initiative was the preparation of a detailed manual, accessible and acceptable to ministries. A draft manual was sent to the ministries in June 1997. After incorporation of comments a final version was distributed throughout the federal government in September 1997. The manual specifies instructions for completing the six sections of RIA:

1. *Purpose of the regulation.* Agencies must list the behaviour to be regulated and the reasons for government intervention. Providing explanation and evidence of the problems that the proposed regulation purports to solve is essential. There are, however, no standard criteria or threshold tests used to evaluate these justifications. Risk assessment is sometimes used for environmental regulations, but not very widely. The quality and scope of data available are rather meagre, so priority setting is seldom done according to pre-established technical criteria. While individual ministries often set regulatory priorities, there has been no serious attempt to do this on a government-wide basis. This section of the RIA must also include an explanation of the legal basis for the regulation. A description of all related regulations (including any international obligations) is included, as well as the reasons they have proven unsatisfactory in dealing with the problem.

2. *Alternatives considered and proposed solution*. Regulators are asked to identify all possible regulatory and non-regulatory responses (including the option of doing nothing) to the problems at hand. The alternatives must be described and the reasons for rejecting them clearly stated. International standards must be considered and preferentially applied based on a case-by case analysis.

3. *Implementation and enforcement*. Implementation and enforcement schemes must be described in detail (sanctions, verification mechanisms, etc.). It is particularly important for the regulatory agency to explain where it expects to obtain the resources needed to apply the proposed regulation effectively.

4. *Public consultation*. Ministries are required to list all parties consulted (including names and telephone numbers) and their opinions. The description of the results of public consultation has often been found to be the most useful part of RIA. Because the data employed in the analyses are rarely of high quality, the opinions of affected parties (appropriately discounted for biases and self-interest) are frequently seen as the most accurate way to evaluate the potential effects of regulations. Nonetheless, an unsurprising tendency for regulatory authorities to minimise any conflicts or differences of opinion and present the chosen regulation as the consensus option has been observed.

5. *Anticipated benefits and costs.* RIAs must include a structured description of the potential costs and benefits of the proposed regulation. The level of quantification and detail of the costs and benefits section is expected to be proportional to the importance of the project. Only regulations of major impact need to quantify benefits and costs extensively. Different

types of costs and benefits must be identified and discussed (effects on capital costs, operation costs, salary costs, consulting/legal costs, conformity assessment costs, health environment or other social costs, administrative costs, etc.), and distributive implications made explicit. The UDE has developed a list of criteria to help regulators self-assess the relative impact of their proposals and thus prepare an appropriate RIA (see Table 4). According to UDE, the biggest problem for the costs and benefits section of the RIA is that the quality of data is generally poor and thus a quantitative analysis of proposals is virtually impossible. Regulatory authorities are not asked to produce net benefit estimates, for fear of creating additional incentives to distort already inadequate data. The UDE has stated that one of its top priorities for further development of RIA is to improve the availability and use of high quality data.

6. *Identification of business formalities*. All formalities created, modified or maintained by the proposed regulation must be listed and described. This is important because it enables the UDE to track changes in formalities and update the federal inventory of formalities on the Internet (see Section 4). Agencies must give specific information regarding the formalities, including the legal basis, rules of application, criteria for decisions, the regulatory authority's maximum permissible response times, and all associated data requirements. Listing these characteristics often helps ministries take a more careful look at their business formalities and make them as simple as possible. Thus, this element of the RIA *pro forma* creates a link between RIA requirements and the review of formalities underway as part of the broader regulatory programme. This innovative aspect of Mexican RIA content may be a promising practice given the widespread attention in OECD countries to administrative and paperwork burdens and means of reducing them.

Table 4. **Threshold criteria in preparing a RIA**

Level of impact	Characteristics of costs	Level of quantification required
Low	· Total annual costs do not exceed 5 million pesos (1997). · Negligible impact on employment and business productivity.	· No quantification required. · Qualitative description of costs and benefits
Medium	· Annual costs between 5 and 500 million pesos (1997). · Non-negligible impact on employment and productivity. · Affects some economic sectors but effects are neither substantial nor generalised.	· Quantification of costs and benefits suited to quantification. · Qualitative description of the rest.
High	· Annual costs greater than 500 million pesos (1997). · Generalised impact on multiple sectors of the economy, employment and business productivity. · Substantial impact on a particular sector, industry or region.	· Complete quantification of all costs and benefits.

Between the start of the programme in September 1997 and June 1999, the UDE reviewed 286 RIAs. The UDE provided technical assistance to regulators in 93 cases to assist them in improving the quality of the RIA. According to the UDE, in the first year of implementation the quality of RIAs and analytical sophistication have slowly improved as regulators develop skills. UDE has developed and applied an innovative scoring system for individual RIAs (see Box 8) that allows tracking of RIA quality on a systematic basis over time. The trend in the scores is upward. The scoring system is also used to identify systematic problems.

Box 8. **RIA grading mechanism**

To track the quality of RIAs by type of regulation and by regulatory agency, the UDE has devised a simple internal RIA grading mechanism. The grade given to each RIA reflects its overall quality, measured as a function of the care with which each distinct sub-component of the RIA was prepared.

There are 14 distinct sub-components by which RIA are measured, and for each of these a grade ranging from -2 (very bad) to +2 (very good) is assigned. These sub-components are:

1. Definition and evidence of the existence of the problem to be resolved.
2. Legal basis for the proposed regulation.
3. Description of existing regulations relating to the same issue.
4. Quality of regulatory alternatives presented.
5. Description of the proposed regulation.
6. Table relating problems identified to regulatory (or non-regulatory) solutions proposed.
7. Description of implementation and enforcement schemes.
8. Quality of implementation and enforcement schemes.
9. Quality of public consultation undertaken.
10. Description of different opinions presented during public consultation.
11. Quality of the description of potential costs and benefits.
12. Quality of the quantification of potential costs and benefits.
13. Degree to which distributional consequences are explicitly stated.
14. Degree to which formalities are identified and described.

The grading of each of the 14 sub-components gives an overall grade of -28 to +28, which is then transformed to a scale from 0 to 10. Agencies have received average grades ranging from 4.4 to 7.3, with an overall average of 6.3. The average quality of RIAs for regulatory agencies/ministries is almost a (positively-sloped) linear function of the number of RIAs sent to the UDE. With this system, the UDE has targeted technical assistance to 30% of RIAs, increasing their score to 1.5 points more than the general average score of 6.0 for all RIAs reviewed.

A more fundamental aspect of RIA compliance has also been tracked and shows a gradual improvement. In the first few months, at least a quarter of the regulatory proposals received by the UDE were not accompanied by a RIA. Subsequently, CJEF has required that any proposals submitted to it without an accompanying RIA be returned to the proposing ministry and resubmitted. As indicated previously, a letter sent by the Comptroller General to all deputy ministers in charge of implementing regulatory reform programmes, reminding them to comply with the RIA programme, was very useful in getting the RIA programme off the ground. According to the UDE, without it, compliance would undoubtedly have been poorer. As of May 1999, the UDE also sends fortnightly reports to Comptroller General on the degree of compliance with RIA requirements. These reports allow the Comptroller General to issue warnings to non-compliant ministries, even in the case of lower-level regulations.

Assessment against best practices

As the RIA requirement is recent, no evaluation of the system or its impact on the quality of regulations has been made. Yet framework issues and methodological aspects are worth noting.

Maximise political commitment to RIA. The use of RIA to support reform should continue to be endorsed at the highest levels of government. The Mexican system rates highly on this criterion. RIA has become a central element of the regulatory reform programme. One important means used in Mexico to achieve this is the requirement that RIAs for proposed laws, presidential regulations (*reglamentos*) and decrees be signed by high-level officials such as the deputy minister, and for other subordinate regulations by general directors before being sent to the UDE**.** An additional element to assure political support and the credibility of the instrument has been the voluntary use by CJEF of RIAs when analysing regulations requiring the president's signature.

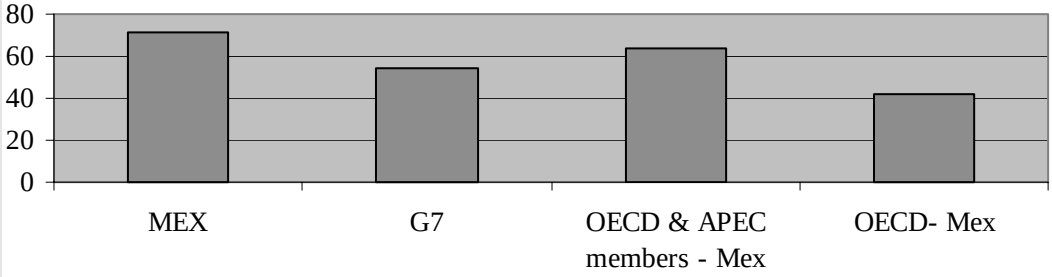
Allocate responsibilities for RIA programme elements carefully. To ensure ownership by regulators while at the same time establishing quality control and consistency, responsibilities should be shared between regulators and a central quality control unit. The Mexican approach has mixed results on this standard. On one hand, except for regulations not covered by the Administrative Procedure Law and the Standards Law, draft regulations must have a RIA reviewed by the UDE. However, the UDE cannot oppose the implementation of poor regulations. UDE's statutory powers permit it delay the implementation of regulatory proposals, oppose the establishment of business formalities, and make public its opinion. For instance, cases of non-compliance with the RIA requirements in the telecommunication sector and of some areas of the Finance Ministry have been reported.

To help regulators fulfil their new responsibilities the UDE established a technical assistance facility. UDE desk officers are encouraged to approach the regulators and help them to understand and implement the new tool. As analytical requirements become more complex these capacities are expected to need enhancement. There is also concern that technical assistance and final review are provided by the same desk officers. Conflicts of interest or even capture may occur as UDE administrators are involved consistently with the same agency.

Train the regulators. Regulators must have the skills to do high quality RIA. As previously indicated the RIA programme was intended to nurture a cultural change among regulators. Mexico has not developed a systematic training programme on RIA. Early in the RIA implementation process, the UDE organised one day general training sessions for regulatory agencies. Subsequently, the UDE has relied on improved guidelines and technical assistance arrangements. With funding from a development bank, BANOBRAS, a pilot seminar on implementing a RIA programme was organised to train public officials in the states. Room for improvement clearly exists. The initial implementation phase of RIA is when the benefits of systematic training will be highest, both in imparting technical skills not widely available and in hastening broader cultural changes within Ministries.

Box 9. **Use of regulatory impact analysis in selected OECD countries**

This synthetic indicator of different elements of regulatory impact analysis (based on self-assessments) ranks more highly those RIA programmes where benefits and costs are quantified, and where a benefit-cost test is used in decision-making. Mexico ranks above the G7, APEC and OECD average on this score. Its score was reduced by the fact that there is no requirement to publicly release RIA documents, and that benefits and costs are not consistently quantified.



Source: Public Management Service, OECD.

Use a consistent but flexible analytical method. The experience with initial BCA requirements for NOMs was negative. It was difficult to reach an adequate level of analytical sophistication when starting from a very low initial base, and lack of an external review reduced incentives for serious work. As a result, the current RIA guidelines have concentrated on changing rational thought processes within regulatory agencies rather than obtaining precise values. Broad quantification of costs, but not benefits, is required. No accounting methodology is proposed. Alternatives not considered need only be described, rather than analysed. However, two additional features of the Mexican RIA programme should be noted. The first is the requirement for a detailed table, cross referencing the problem to be solved with the solution proposed, including the contribution of each part of the regulation. Any requirements left out of this table need to be specifically justified. Secondly, analysis of proposed formalities must be more extensive, including an identification of the existing formality (where applicable) or, in case of a new formality, a justification of why approval is needed rather than notification.

Develop and implement data collection strategies. An essential part of the RIA guidelines consists of a thorough discussion of the consultation process during preparation of the proposal. This is to encourage regulators to solicit views from affected parties of the likely impacts of proposals. From the UDE view, the list of consulted parties provides information about the quality of the data collection strategy as well as potential bias. However, the RIA guidance material developed by the UDE has not incorporated elements to help agencies to develop data collection strategies, such as surveys, structured public consultation, econometric tools, etc.[46]

Target RIA efforts. RIA resources should be targeted to those regulations where impacts are most significant, and where the prospects are best for altering outcomes. In all cases, the amount of time and effort spent on regulatory analysis should be commensurate with the improvement in the regulation that the analysis is expected to provide.[47] The Mexican approach can be characterised as "partially

targeted", in that, while the RIA requirement applies to all draft regulations, three broad levels of analytical rigour and effort are distinguished by guidelines, depending on the importance of the regulation (see Table 3 above). The intention is to target the use of resources without losing the possibility of building a complete regulatory inventory.

Integrate RIA with the policy-making process, beginning as early as possible. The UDE believes that the current RIA approach is less confrontational and more co-operative than the previous system. In particular they underline their emphasis on the provision of technical assistance early in the drafting period.

Involve the public extensively. RIAs have become important working tools for the reviews by the UDE and the CDE working groups. Even if the UDE cannot prevent the passage of a proposed regulation with a RIA that is deemed unsatisfactory, the law permits it to make public its concerns. To promote public participation, the UDE has begun to publish on its Internet web page a listing of all proposals that indicates if they complied with RIA requirements. This possibility is also very important for promoting compliance by agencies that may otherwise try to bypass regulatory oversight. However, neither SECOFI nor the Council has the legal obligation to publish the RIA. Public availability of RIAs and the Internet listing of proposals dependent on SECOFI and the Council's political will. A clear requirement for open public consultation based on RIA, incorporating key procedural safeguards, remains a significant gap in the Mexican system. The concerns expressed by reform officials about data quality in RIA highlight the potential gains from addressing this shortcoming.

Apply RIA to existing as well as new regulations. RIA disciplines are equally useful in the review of existing regulation as in the *ex ante* assessment of new regulatory proposals. Indeed, the *ex post* nature of regulatory review means that data problems will be fewer and the quality of the resulting analysis potentially higher. Currently, Mexico has not used RIAs to analyse existing regulations, or even formalities. This is a major area into which RIA use could be extended.

3.4. Building regulatory agencies

Implementing systems for regulatory scrutiny and review is necessary but not sufficient for a successful programme of regulatory management and reform. Also of primary importance is the development of well-designed regulatory institutions and a change of culture among regulators. Three issues should be considered in this respect. First, how can accountable and independent institutions which resist capture by interest groups, either public or private, be established. Second, how can the accountability of regulators be improved. Thirdly, how can regulators be trained and equipped with the requisite skills and attitudes for the making of high quality regulation.

In parallel to the general overhaul of the legal framework, the pace of institution building has accelerated and a new type of regulatory institution has appeared in Mexico.[48] These new entities have three common characteristics: a high degree of technical specialisation, a concentration on regulatory or enforcement aspects, leaving policy or normative matters to the ministries, and a greater degree of autonomy, particularly concerning budgetary and human resources policies.

However, the new institutions are quite different from one another. For instance, in relation to their legal autonomy *vis-à-vis* the executive branch, these entities can be divided in broad terms into four categories (the dates noted are those of the most recent reforms):

- *Independent from the Executive branch:* The Central Bank (*Banco de Mexico*) (since 1994); the Electoral Institution (*Instituto Federal Electoral* - IFE) (since 1996).

- *Independent inside the Executive branch:* National Commission for Human Rights (CNDH) (since 1992), the Federal Competition Commission (CFC) (since 1994).

- *Policy setting partially autonomous and technically independent*, Regulatory Energy Commission (CRE) (since 1995).

- *Technically autonomous from the sectoral ministry*: Federal Telecommunication Agency (COFETEL) established in 1996,[49] the banking and security industry commission[50] (*Comision Nacional Bancaria y de Valores*), the Unit of Unfair International Trading *(Unidad de Practicas Desleales de Comercio Internacional*), the National Institute of Ecology, or the National Water Commission (CONAGUA), Revenue administration (*Servicio de Administracion Tributaria*) in 1997, etc.

Additionally, midway between the judicial and executive branches, some new prosecutorial agencies have been created for specific policy areas such as consumer protection in 1994 (*Procuraduria Federal del Consumidor*), the environment in 1993 (*Procuraduria Federal del Medio Ambiente*) and family and minors issues (*Procuraduria del Menor y la Familia*).

This increasingly complex institutional setting offers great potential in improving regulatory efficiency. The specialised and more autonomous regulators have created important "checks and balances" to match the powers of ministries and interest groups and increase the speed and quality of regulatory decisions. Their operation are also more transparent and accountable. Most of the new regulators have their own budgets and human resource policies. Economic regulatory agencies, like CFC, CRE, and COFETEL, have moved to the use of fixed term appointments for their most senior executives, with removal possible only on limited grounds. Academics and businessmen have begun to be nominated to the boards of these organisations.

Some issues remain unresolved. First, appointments to most of the institutions are still made by ministers, rarely by the president and even more rarely (notably in the case of the central bank and electoral institute), are confirmed by the Senate. Thus, for many appointees, independence is constrained by career considerations. A conflict with the minister in charge of the sector may be costly for the individual regulator and for the institution. Second, though some of the new regulatory agencies have a more autonomous, and thus more "attractive" staff policy, they are still severely limited by the quality of personnel. The rapid rate of creation has put a high premium on technical specialists in an already tight professional labour market. The superior attractiveness of jobs with the independent agencies has, at the same time, further weakened the ministries' ability to recruit and retain high quality regulatory staff, while a lack of training of the regulators (see below) ensures that the problem persists. A consequence is that economic regulators are technically vulnerable to special interests supported by private consultants. Third, their legal status has not always guaranteed *de facto* autonomy from the ministries. The agencies are dependent in many ways on the relevant sectoral Ministry. In a highly hierarchical administrative culture, most chief regulators must convince "their" minister to implement their decisions. Additionally, in some cases the procedures of the independent agencies are deficient in terms of accountability and transparency. For instance, the existence of a large amount of discretionality in the definition of powers of COFETEL and CRE may create incentives to act as active proponents of an industrial policy protecting national champions.[51]

Lastly, the creation of this web of regulatory institutions has been a product of partial modifications and has lacked a coherent and explicit design. In some aspects it resembles the US and UK models of sectoral regulatory commissions. In others, it resembles the French model of ministerial control through the grant of concessions. Important economic sectors lack an independent regulator, for instance the audio-visual and rail and freight transport sectors. Regulatory powers among the established regulators vary in scope and scale. For example COFETEL is less independent from the Ministry of Transport and Communication than the CRE from the Ministry of Energy, but the latter deals mainly in a sector where powerful state-owned players are still dominant. The Water Commission has not only important regulatory powers but also executive duties, employing more than 24 000 employees around the country. Further, vital co-ordination and harmonisation mechanisms are lacking, even when much of the theoretical foundations are similar. For example, essential issues like controlling prices or managing access arrangements for "essential (or network) facilities" or interconnection prices differ between agencies. This may lead rapidly to institutional erosion as rent-seeking firms attempt to arbitrage among the regulators in an attempt to find the most attractive protected niche activities.[52] Crucially, legal and institutional consistency is lacking between the competition authority and the sectoral regulators, in particular in regard to the extent and form of the oversight role of the competition authority. Presently the CFC links with sectoral regulators through its participation to inter-ministerial committees at sub minister level, through the authorisation of participants to the privatisation process, and through binding opinions for existing regulations and non-binding opinion for new regulations. These are important elements but additional co-ordination mechanisms and improvement of CFC oversight role may be needed in the future[53] (see also background report to Chapter 3).

Another contributor to the quality of the civil service in the regulatory bodies is the training of regulators. Some important regulatory failures can be blamed upon lack of expertise among the personnel concerned. For instance, administrative failures by the highways regulator (*Caminos y Puentes Federales*, part of the Ministry of Communication and Transport) in managing the concessions to private operators, induced higher than expected construction costs and further exacerbated their financial situations after their privatisation.[54] Equally, some responsibility for the financial sector crisis of 1994 has been attributed to major failures in regulatory supervision.[55]

In the rapidly changing environment of Mexico of the late 1990's, human capital shortages cannot be solved in the short term. Nor can reforms wait on the availability of optimum implementation capacities. However training regulators can pay handsomely. UDE has made some efforts in this field. They are, however, insufficient in relation to the challenges.

4. DYNAMIC CHANGE: KEEPING REGULATIONS UP-TO-DATE

The *OECD Report on Regulatory Reform* recommends that governments review regulations systematically to ensure that they continue to meet their intended objectives efficiently and effectively. For many decades, the Mexican legal system accumulated regulations and formalities without any effort to review their compatibility or their adequacy in changing social and economic environments. In the past few years, however, substantial progress has been made to review and improve or eliminate this stock of regulatory requirements. Five initiatives are discussed below.

Review of existing formalities. Formalities, and in particular licences and permits, are seen as a major problem and a major contribution to the cost of doing business. In some cases, they have functioned as entry barriers, particularly for SMEs. According to a World Bank estimate, without considering transaction and opportunity costs, opening a business could take up to a year and a half, while the costs of complying with all the formalities governing business operations in some cases account for about 3% of a

large firm's operating expenses.[56] Additionally, the previous existence of an unspecified number of formalities—sometimes regulatory agencies did not know how many formalities they were responsible for—created a state of uncertainty and opportunities for corruption. Hence, reforming formalities became a high priority in the regulatory reform programme. The ADAE sets out a precise review procedure to "eliminate or simplify unnecessarily burdensome information requirements". At the end of this review and any reforms, a list of the official "deregulated" formalities for each ministry is published in the *Diario Official*. At publication, the formalities listed are included in the Federal Registry of Business Formalities. Through this process, the Registry should be comprehensive—that is, the Federal Registry must include the full set of enforceable formalities – and should provide legal security to businesses.

The review programme had four stages. First, an inventory was drawn up, through a detailed reporting requirement in which all ministries needed to answer a range of precise questions for each one of its formalities. This systematic analysis enhanced regulatory communication, as most of the ministries did not know the exact number of their formalities. It was also a deregulation mechanism, as ministries "cleaning up their house" voluntarily eliminated outdated and illegal formalities, rather than reporting them. In December of 1996, the inventory was published on the CDE web page.

Second, once a ministry's formalities were identified, the UDE began reviewing the formalities for each ministry in a sequential order (see Box 10).

Box 10. **Reviewing a formality in Mexico**

1. A ministry's inventory of formalities and related documentation is handed to a special advisory group composed of business persons and other interested parties. A deadline is established for receiving individual proposals.
2. In parallel, a UDE desk officer and team examines each formality in detail and prepares proposals based on the regulatory reform criteria established in the ADAE. The review is based on the following checklist:

- Can the formality be eliminated?
- Can an alternative be found, for instance changing a permit into a notification or a set of general rules to be verified *ex post*?
- Can the authority's response time be reduced and an automatic approval system established?
- Can individual information requirements (including annex documents) that constitute the formality be eliminated?
- Can other elements of the formality been improved?

3. A document presenting the final proposals for each formality is presented to the regulatory agency and after a negotiation process generally lasting between three and nine months and meetings of the executive commission (in which the private sector participates actively), the package is presented to the CDE by the corresponding minister for approval.
4. The regulatory agency, with the help of the UDE, implements the approved proposals. This stage is a delicate and resource intensive process due in part to the Mexican civil law system. At least three distinct legal instruments must be prepared depending on the elements to be reformed. Formalities may be established in a law, in a presidential regulation (*reglamento*), in a ministerial instruction, or in a combination of these. The simplest, and hence more rapid, reforms modify a ministerial instruction. Changes to laws and presidential rulings require the involvement of the CJEF. Finally if a law is reformed, Congress must be involved. A "deregulation package" is negotiated and passed. Complete implementation of a ministry approved proposal that includes legislative changes can take up to two years.
5. After publication of a detailed description of reviewed formalities in the Federal Official Gazette, the UDE registers them in the Federal Registry of Business Formalities.
6. The Comptroller General verifies the administrative implementation of the reforms through a set of performance indicators developed by the Modernisation of the Public Administration Programme.

The process has not been completed, but the mechanism has been launched through the whole of the administration. To date, ten out of twelve federal ministries subject to review have completed the first step of the formality reviews, that is, each minister has presented to the CDE and committed specific reforms to the formalities they are in charge of (see last column of Table 5). According to the latest report, the review process has resulted in official commitments to eliminate around 50% of the mandatory formalities already reviewed.[57] In addition, ministries have agreed to simplify and improve 97% of the remaining formalities. Although the programme seems to be taking the right steps to improve the administrative environment for business by increasing transparency and simplifying federal formalities, the overall regulatory burden reductions and estimated potential cost-savings are not yet studied nor documented.

Table 5. **Progress in the review for existing formalities (June 1999)**

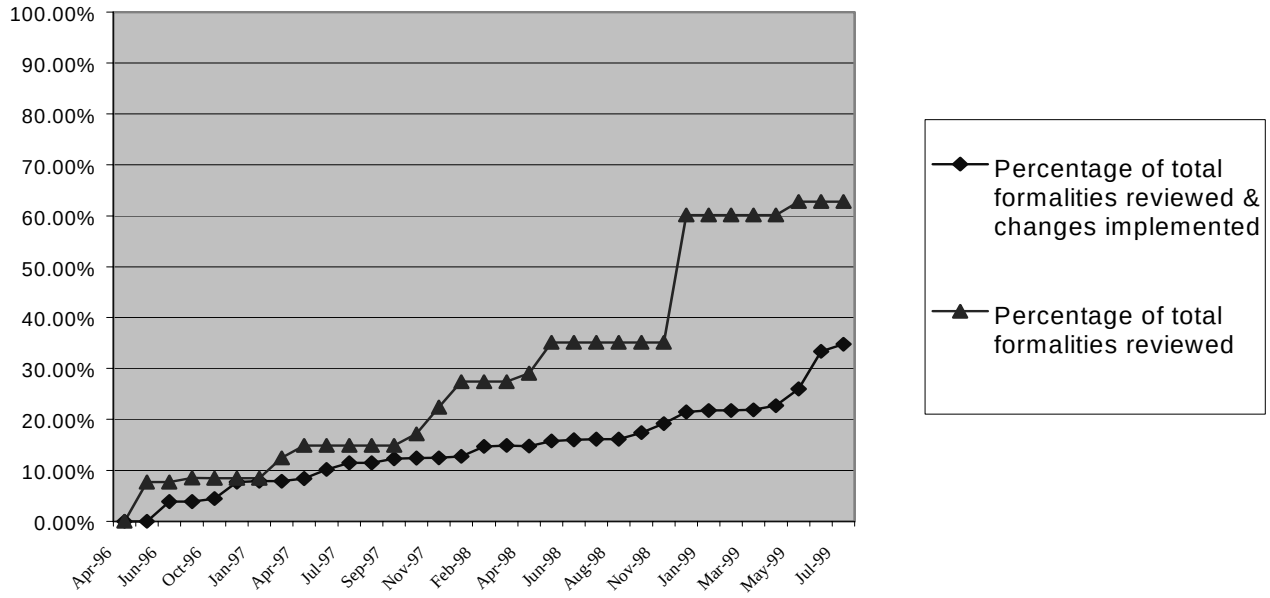
Ministries	**Number of formalities before the review process**	**Percentage of formalities eliminated upon full implementation of reform commitments made to the CDE**	**Degree of legal implementation of reform commitments**	**Percentage of remaining formalities simplified and improved**
Trade and Industry	227	37%	100%	85%
Foreign Affairs	24	8%	100%	76%
Health	115	42%	89%	98%
Labour	72	47%	99%	92%
Tourism	67	27%	99%	92%
Environment	155	13%	42%	99%
Education	146	71%	81%	100%
Agriculture	48	13%	90%	100%
Energy	179	18%	90%	99%
Communications and Transport (1)	736	67%	20%	100%
Interior	77	0%	0%	100%
Finance	1 027	Review not yet completed		
Communications and Transport (2)	67			
Total	2 940	47%		

(1) Without the Postal Service and the telecommunication sectors.
(2) Only the telecommunication sector.

Source: Official communication from the government of Mexico, UDE, June 1999.

The process for the review of formalities is well designed, incorporating a significant level of involvement from affected parties and a strong role for the regulatory reform body, which is able to take an "independent" view. At the same time, dialogue and negotiation with the administering Ministry provides a means of ensuring implementation of the reform as well as a check on feasibility. However, the progress of the reform has been slower than originally expected. In the three and a half years since the programme started, 63% of the stock of business formalities has been reviewed and 28% of the agreed changes are not yet implemented in law and subordinated regulations (see Figure 1).

Figure 1. **Progress made in improving business formalities**



Source: UDE June 1999.

Two main problems have slowed the reaping of benefits by consumers and businesses. First, although by the end of the summer of 1999 the UDE will have finalised the review of the whole set of formalities (with the review of the 1 027 formalities of the Ministry of Finance and of the 67 formalities of the telecommunications sector), the implementation of agreed changes would still be a few months away. Indeed, an essential element to produce results is the needed enactment in laws and subordinated regulations of the changes agreed by ministries and agencies at the CDE. Although 64 legal instruments directly related to the implementation of the regulatory reform programme have been adopted since 1995 (17 laws, 19 *reglamentos* and presidential decrees, and 28 ministerial decrees), Graph 1 shows that, in the last year, the gap between reviewing and implementing changes has grown. This situation is attributable to complex factors. One reason refers to the structure of Mexico's legal system where a reform needs to start at the level of a law before being consolidated in a subordinate regulation. As discussed in Section 1 the emergence of a cohabitation government has meant that more time is needed to prepare and enact legal reforms through Congress. Another reason is that a large number of formalities from the Ministry of Communications and Transportation and from the Ministry of Finance (two-thirds of the total) were the last to be reviewed. Nevertheless, because the typical lag time between review and legal implementation of formalities is approximately eight to ten months, most of the legal and regulatory implementation phase should be finalised by the end of 1999 or early 2000.

A second point is that the review process has to date included only those formalities with an impact on business. Considerable benefits may flow to citizens from implementing a similar process for formalities impacting on their daily lives. Adopting such a programme could also help broaden understanding of, and support for, the broader reform process.

Improvement of the concession system. Where an activity is defined as a public service, there are legal constraints on the form of regulatory instrument that the Mexican government can use. The Constitution provides that such services may be provided by the private sector under a concession. The concession creates legal rights and duties that are different than those in a licence or a permit. A concession, unlike a permit or license, entails federal jurisdiction over labour, fiscal and other regulatory matters. Thus, when federal road transportation shifted to a permit system in 1989, regulatory powers devolved to the states and municipalities. Design of concessions also has economic consequences. If a concession period is too short, incentives to invest are reduced, and temptations for abuse increase. The concession title also has accounting and fiscal effects, resulting from the fact that the firm does not own the assets. And concession titles can also raise administrative problems, as loosely defined concessions may permit excessive discretion and legal uncertainty. This, however, has not significantly deterred private sector entry.

In the last few years, Mexico tried to limit the use of this *ex ante* regulatory instrument and improve the concessions that still are needed. In some cases, the status and definition of public service for a given activity was reformed to allow the creation of licences and permits or other instruments needed to regulate private property rights. In other cases, where the public service concept was maintained, the concession system has been revamped with longer terms, nearly automatic renewability, precise performance requirements, or dispute resolution mechanisms. These new forms of concession more closely emulate permitting or licensing systems. Indeed, in some cases they are more transparent and efficient. The improvements have dramatically reduced regulators' discretion. The mining concession and the related auction procedures are good examples.

Ad hoc review of existing regulations. Mexico has not established an institutionalised process to systematically review existing regulations as it has done with business formalities. Rather, the UDE has taken an *ad hoc* approach. The review of federal business formalities has led to a *de facto* review of many existing regulations. Since formalities are imbedded in an array of laws and regulations, the reviews have inevitably considered broader aspects of the regulations. This occurred particularly in the case of the reviews of the ministries of environment, health and labour where formalities and regulations were comprehensively reformed as part of a comprehensive package.

Sectoral work groups. In 1998, to accelerate reforms in important sectors of the economy, the UDE/CDE established advisory working groups to consider regulation in four economic sectors: textiles, tourism, mining and construction. These groups worked with a similar approach to those concentrating on a single ministry. However, due to lack of resources this group approach has been abandoned.

Elimination of out dated regulations. As part of its enacting decree in 1992, the Federal Metrology and Standards Law required that all minor rules related to standards on health, safety, environmental risks or consumer information covered by the Law should be replaced by a NOM. The law also mandated a 15 months transition period, after which the remaining rules would become void. No study has been done on this measure but anecdotes indicate that this radical "housekeeping" exercise resulted in a considerable deregulation.

In December 1997, the UDE and the CJEF, after an exhaustive analysis, published in the Federal Official Gazette a decree abolishing 181 laws and regulations considered obsolete.

Sunset approach for reviewing NOMs. Looking forward Mexico has initiated the use of sunsetting measures. One of the 1997 amendments to the Federal Metrology and Standards Law was the mandatory review of all technical standards (NOMs) every five years. Every regulatory agency must study the effectiveness of each of its NOMs before the end of every five-year period since its inception, and

present the results of the analysis to the corresponding consultative committee. If the study shows the NOM to be deficient, the regulatory agency must initiate procedures within the committee to eliminate of modify it. If the quinquennial review is not performed, the NOM in question is no longer enforceable. Additionally the law now also stipulates that all NOMs must be reviewed within their first 12 months of operation to determine whether they are operating as anticipated.

Support SMEs and other initiatives to improve the regulatory environment. Together with the initiative to install one-stop shops (*Ventanillas Unicas de Gestion)* in most of Mexico's cities (see Section 3.1.6), virtually all federal ministries have created, individually or together with other agencies, specialised offices to provide information or help to process formalities. In addition, many one-stop shops created by business and industrial associations and state and municipal governments allow businesses to process most of their formalities. The National Industrial Association (CANACINTRA), for example, has created 8 such one-stop shops, the National Restaurant Association (CANIRAC) 2, the Mexico City National Chamber of Commerce (CANACO) 7, the National Architects Association 2, state governments over 90 and municipal governments over 20. In Mexico City there are now over 30 different offices to which business people can go to for information on local regulatory requirements or to directly present applications for business licences and permits.

5. CONCLUSIONS AND POLICY OPTIONS

5.1. General assessment of current strengths and weaknesses

Regulatory reform in Mexico is part of an historic process of social, political and economic change, and while it is a key contributor to these broader changes, it is, in turn, constrained and shaped by them. The future prospects of regulatory reform are therefore inextricably linked with the evolution of these wider reforms.

Mexico has moved further and more quickly in bringing its regulatory system up to international standards than has most OECD countries. The only countries that compare in terms of the magnitude of the policy response are eastern European countries involved in the transition to market democracies. This review has shown, however, that the distance yet to travel is large, and warns that future progress depends on the support of new actors and interests in the multi-party and federal system. Given that the regulatory reform programmes are relatively recent and have moved so quickly, gaps in concept, design, and implementation have inevitably opened and remain to be resolved. This is recognised in Mexico. What is needed now is a moderate rebalancing of the programme toward a broader vision of social welfare to help build a wider constituency, combined with a multi-year period of consolidation, sustained implementation, and refinement of the legal and policy reforms already on the table. This will permit legal and policy reforms to trickle down through the administration so that citizens and businesses see concrete benefits.

The Mexican experience offers lessons that should be considered by other Member countries. Regulatory reform has received clear and sustained support at the highest level of the federal government—a factor that has been of key importance in empowering the bodies within the administration charged with co-ordinating, monitoring and promoting reform. These administrative bodies have been given clear, well formulated roles and high quality staff and have been active in pursuing reform. Other key strengths include a well-formulated set of RIA requirements including, unusually, consideration of the feasibility of implementation.

The process for developing technical standards is a well designed reform, embracing both procedural and technical safeguards, and is of interest in the development of best practices in this important area. Development of on-line searchable databases of regulatory formalities is well advanced and will put Mexico at the forefront in the use of this important tool for better communication on regulatory standards. Progress has been made to review and streamline administrative formalities and reduce paperwork barriers to entrepreneurialism. Integration of federal, state and local government regulatory reforms is also an area in which Mexico is in the front rank. Virtually all states have now agreed to implement reform programmes based on consistent principles, and have made progress in encouraging commitments from municipal governments to do likewise. Consequently, the overall level of reform activity seems to have been successfully "leveraged" by the federal reform strategy. Transmission of reform to the sub-national levels of government should help broaden its base and deepen its roots.

Five important challenges should be faced to deepen the transformation or the regulatory environment and to improve prospects for further reform.

- The most pressing concern is the implementation gap. Mexican officials have expressed concern that problems with the quality of human resources and public management continue to hamper the effective implementation of reforms. This is compounded by compliance and enforcement issues, including judicial weaknesses, in ensuring that regulatory reforms are translated into real benefits to society. This issue has importance for a range of issues beyond regulatory management and reform *per se.* Over the longer-term, a cultural change among regulators is needed. Development of a more transparent, results-oriented, and accountable means of operating is slowly emerging, but is very fragile and not well supported by the broader legal and administrative environment.

- Transparency has improved significantly at both policy and implementation levels through a series of mechanisms to release more information, clarify regulatory requirements, and standardise the use of administrative discretion. Yet, Mexico still falls far short of international good practices, particularly in the use of public consultation. Procedural requirements exist in some areas, such as standards, but there is no comprehensive, standardised consultation requirement for regulations. Mexican citizens still have no general right to comment on regulatory decisions affecting their lives.

- Regulatory reform should be more clearly harmonised with other structural reform policies, in particular with competition advocacy and administrative reform policies.

- The central locus of reform which has always been situated in the Ministry of Commerce and Industry may gain in power, effectiveness and efficiency if moved to a higher and more central management position.

- The *need to rebalance the reform programme* between deregulation and good regulation, particularly sectoral governance and consumer protection, is urgent in Mexico, as it is in Japan. Notwithstanding the extensive support from the business community, a fundamental issue to sustaining regulatory reform will be to broaden its constituency to consumer and citizens and, in parallel, to increase involvement of the Congress, which is expanding its role in policy development in Mexico. This will require that the move, already launched, toward regulatory quality rather than deregulation as the guiding principle for reform should be more explicit and its implications clarified to a wider range of social interests.

5.2. Policy options for consideration

The policy options below suggest concrete actions that should be considered to address the five challenges identified above. The strategies recommended are in accord with basic good practices in other countries. Some of the recommendations can be carried out quickly, while others would take some years to complete.

- *Establish consistent government-wide standards for regulatory quality by closing gaps, eliminating exemptions in the current policy framework and expanding the review programme beyond "business" regulations to all significant regulations.*

Good regulatory practices already established for significant portions of Mexican regulatory activity should be expanded government-wide. Broad exemptions to ADAE, the Administrative Procedure Law, and the technical standards law, combined with the non-mandatory nature of some policies, has resulted in a fragmented policy regime for the use of regulatory powers. The focus on business regulations can distort the establishment of an efficient, consumer-oriented regulatory framework and reduce the general public support for the programme. These gaps undermine the use of regulatory impact analysis, independent review, codification, and public consultation. The Administrative Procedure Law, which sets down the powers that may be exercised by administrative agencies, principles governing those powers, and legal remedies to those aggrieved by administrative action,[58] would be an important vehicle to improve and strengthen the regulatory process—from "cradle to grave", and any exemptions should be very narrowly drawn.

- *Further improve transparency by extending legal requirements for notice and comment procedures, already required for technical standards, to all ministries and agencies during the development and revision of regulation. Procedures for openness should be standardised for all advisory bodies.*

Adoption of a general consultation requirement covering all substantive new laws and lower-level rules would promote both the technical values of policy effectiveness and the democratic values of openness and accountability of government. Notice and comment processes are based on clear rights to access and response, are systematic and non-discretionary and are open to the general public as well as organised interest groups. Advisory groups may continue to be needed to establish dialogue with experts and interest groups, and standard procedures for their use are necessary to ensure that they do not undermine the transparency of the regulatory system. The system could also be strengthened by requiring that all regulatory projects be published together with the regulatory impact analysis (see below).

- *Improve the efficiency, independence and accountability of the new regulatory agencies by strengthening their systems of governance, policy coherence, working methods, and relations with the competition authority. A first step should be the launching of a comprehensive, high-level and independent review of the performance of the new regulatory agencies, followed by appropriate revisions to their missions, authorities, and work methods in laws and other regulations.*

The rapid increase of Mexican autonomous and semi-autonomous regulatory agencies is changing the legal and administrative environment where businesses operate. This is even more consequential when new utility and network industries are privatised, opening new markets that were reserved to the State to competition, and when new regulatory frameworks for state monopolies are devised. However, this institution-building has been done without a consistent framework for efficiency,

accountability, and transparency. Performance has not been assessed in most cases, and questions remain about, for example, the relationships between sectoral regulatory agencies, linkages with the competition authority, and accordance with procedures of the judiciary. It may be useful to evaluate the feasibility in Mexico of a multi-sectoral regulatory institution to share resources, facilitate learning across industries, reduce the risk of industry or political capture, and deal with blurring industry boundaries.

An independent expert group should review the institutional architecture for market-oriented regulation in order to determine if a new harmonised framework would improve efficiency and competition in the regulated areas of the economy. Recent experiences in the United Kingdom, where a *Green Paper* was recently prepared,[59] and the in-depth work done by the inter-ministerial commission of Chile could be models.

- *Promote quality regulation by transferring the CDE/UDE to a location at the centre of government with cross-cutting management and co-ordination authorities, such as the president's office, and by strengthening its attention to consumer protection and citizen welfare.*

The Ministry of Trade and Industry has carried regulatory reform very far indeed, reflecting its strong position in economic policy and commitment to competitive markets. The next step in the reform process is integration of regulatory quality concepts and processes into the core policy-making machinery of government. Experiences in some OECD countries suggest that placing central regulatory management in the centre of government linked to the offices of the president, prime minister, or budget enhances the authority and oversight needed to steer the process and obtain results. This is particularly likely in the Mexican setting, where administrative hierarchy has high value. Another important concern is to improve co-ordination with other entities in charge of structural reform policies, as well as with those closely related to budget and public human resource policies. A new setting could also be the occasion to widen the reform strategy and involve more actively Congress and non-businesses interests.

Moving from a line ministry to the centre of government has important implications for the content and scope of the programme. The UDE should consider broadening its responsibilities, reducing exemptions, and pursuing a government-wide approach to regulatory quality. In particular, a wider view of how good regulation and deregulation together can maximise social welfare would be necessary to maintain the legitimacy and effectiveness of the UDE at a higher management level. The role of consumer protection measures within comprehensive reform strategies should be more prominent in the programme. Many countries have neglected to install consumer protection regimes that work well in new market conditions. In some countries, abuses against consumers have caused backlashes against reform itself. This failure stems from the mistaken notion that market liberalisation means less of all kinds of regulation. On the contrary, in some areas it may mean more. Balancing business interests with consumer interests will increase the credibility of a new unit, and broaden its appeal. For instance, the UK's Deregulation Unit, moved in 1996 from the Trade and Industry Ministry to the Cabinet Office and changed in 1997 its name to the Better Regulation Unit.

- *Strengthen disciplines on regulatory quality in the ministries and agencies by refining tools for regulatory impact analysis, lawdrafting, and use of alternatives to regulation, and training public servants in how to use these tools for regulatory quality.*

Since its creation the UDE has been instrumental in designing and implementing new tools to improve tools for regulatory quality, such as those contained in the Federal Metrology and Standards Law, the Federal Competition Law, and RIA requirements. However, a tool needs not only to be well designed but used, that is, incorporated into daily administrative practices. Implementation should be backed up by adequate resources and incentives for compliance. Action would be useful in four areas:

i) *Require that RIAs be systematically published during the notice and comment process for each regulation.* RIA can be a powerful tool, especially if integrated into notice and comment procedures that can generate better information about the consequences of regulation. RIA can also help increase transparency and accountability across the administration. It can help the Mexican government effectively manage increasingly complex regulatory policies, in a way similar to the management of budget policy. In the short run, the UDE could use its discretionary powers to supplement the list of proposals with addition of the RIA.

ii) *Train public sector employees in how to conduct regulatory impact analysis.* If the RIA programme is to deliver its potential benefits, two steps should be taken. First, the development of skills in regulatory agencies must be improved. Currently, skill levels are low, and the level of quantification and data analysis remains poor. Second, adoption of a "notice and comment" requirement open to the broadest possible range of interests provides an excellent opportunity to collect better information and to provide quality assurance on RIAs. RIA should be fully integrated with notice and comment procedures.

iii) *Promote the adoption of alternatives to traditional regulation by developing guidance and training*. Regulatory and non-regulatory alternatives to traditional "command and control" regulation can increase policy effectiveness and lower cost. Regulators must be motivated through results-oriented management to consider the use of alternatives and to design appropriate ones for particular policy problems. This requires strong encouragement from the centre of government, supported by training, guidelines and expert assistance where necessary. Where rigid laws and legal culture inhibit use of more effective alternatives, broader legal reforms to allow more innovation and experimentation may be necessary.

iv) *Improve regulatory clarity and simplicity through better lawdrafting.* An important problem with regulatory quality in Mexico is the complexity in the structure of the regulatory regime and in the comprehensibility of regulatory text. The principle of plain language drafting should be adopted, and quality controls on technical law drafting should be put into place in each ministry. Such controls could be supplemented by measures to improve the skills of lawdrafting staff and to standardise approaches through guidelines and training.

- *Speed up effective reform by adopting a systematic and comprehensive approach to the review of existing laws and regulations.*

More attention should be placed on systematic review and upgrading of regulation through, for example, a rolling review process based on a prioritisation of policy areas, as is already beginning by the UDE. Structuring of an effective review process will be key to its results, and may require strengthening the capacities of the UDE and co-ordination with the competition authority. The Australian competition principles review, which includes both federal and state governments, provides an interesting model. Such reviews should be based on benefit-cost principles, that is, on maximising social welfare. In key sectors,

the reinvention principle should guide the reviews. The effectiveness and speed of more comprehensive sectoral plans based on all policy measures needed for results, including regulations but also other forms of intervention such as subsidies, procurement policies, and tax policies has been demonstrated in other countries. The "reinvention" of sectoral regimes—based in part on international benchmarks—allows reformers to consider policy linkages and related measures needed to make reform effective, to package related reforms into a coherent programme, and to reassure market entrants that reform is credible and predictable. Adopting reform steps in law, as opposed to leaving the timing or steps to the ministries, will further strengthen the accountability, credibility, and sustainability of reform.

- *Review laws and regulations to improve concession processes.*

In the past, regulation of the private sector in the Mexican network and natural resources industries though concessions has sometimes been costly, complex, opaque and overly discretionary. The design of concessions has improved markedly in recent years in some sectors. A more precise delimitation of which activities are considered public services has transformed many concessions into permits and licences or replaced them with other regulatory alternatives. This line of work should be continued and systematised for remaining concessions so as to reduce use of this instrument to a small core of public services and improve constitutionally required concessions to reduce any unnecessary discretion in their management.

- *Further encourage regulatory reform by co-ordinating with the states and helping them to develop management capacities for quality regulation.*

While initiatives to date in this area are pioneering, the process is far from complete and evidence exists that state level regulation may be frustrating reforms made at federal level. Progress in decentralising and deconcentrating regulatory powers to bring them closer to citizens and business may also create potential concerns for a coherent and efficient national regulatory system in the future The adoption of state based programmes of reform based on consistent principles should form the basis for more formal co-operation measures, including consideration of establishing for a for resolving issues arising from regulatory conflicts. An additional and complementary strategy should continue to be developed to help the states encourage municipalities to launch regulatory reform programmes. Continued leadership from the centre to encourage experimentation will be needed to promote efforts.

A particular concern refers to improving regulatory frameworks for private participation in states' and municipalities' utilities and public services. One possible model to be further investigated is the one used by the *Fondo para la Vivienda* (FOVI) to provide concrete incentives to implement reform proposals.

NOTES

1. OECD (1997), *Issues and Developments in Public Management*, Paris, p. 209 - 225.

2. "Notes: Liberlismo contra Democracia: Recent Judicial Reform in Mexico", *Harvard Law Review*, 1995, Vol. 108:1919, pp. 1919-1936.

3. Sempe, Carlos (1997), *Tecnica Legislativa y Desregulacion*, Editorial Porrua, pp. 193-201.

4. Taylor, Michael (1997), "Why No Rule of Law, in Mexico? Explaining the Weakness of Mexico's Judicial Branch", *New Mexico Law Review*, Vol. 27, winter, p. 143. It should also be noted that citizens are allowed to carry out any activity that is not prohibited by law. Authorities, on the other hand, may only regulate activities or impose specific obligations if instructed to do so by a specific law or *reglamento*. No other type of subordinate regulations (except NOMs) may impose obligations or requirements on citizens.

5. See OECD (1999), *OECD Reviews of Regulatory Reform, Regulatory Reform in the United States*, Chapter 2, Paris.

6. López Ayllón, Sergio (1995), "Notes on Mexican Legal Culture" in *Social and Legal Studies*, Sage, Vol. 4, p. 481.

7. López Ayllón, Sergio (1997), *Las transformaciones del sistema jurídica y los significados sociales del derecho. La encrucijada entre tradición y modernidad*, México, UNAM, p. 470. See also, Elizondo, Carlos (1993), "The Concept of Property of the 1917 Mexican Constitution", Working Paper 10, Division de Estudios Politicos, Centro de Investigación y Docencia Economica, p. 15.

8. López Ayllón, S. (1997), p. 202 and p. 221.

9. World Bank (1990), *Mexico Industrial Policy and Regulation*, pp. 23- 28.

10. According to López Ayllón, S. (1995), NAFTA also introduced some elements that are characteristic of a common law system into Mexico, in particular the concept of law according to which norms may be applied to their most minimal detail and the external enforcement scrutiny exists, for instance, concerning the possibility of the Mexican State being subject to international procedure of dispute.

11. For the first two periods see Levy, Santiago (1993), *Trade Liberalization and Economic Deregulation in Mexico in Public Administration in Mexico Today*, Fondo de Cultura Economica y Secretaria de la Contraloria General de la Federacion, p. 121. For the last period see UDE (1998), Direct communication from the UDE, July.

12. OECD (1997), *Issues and Developments in Public Management. Survey 1996-1997*, Paris, p. 209-213. On previous achievements see Vazquez Cano, Luis Ignacio (1993), *Administrative Simplification in Public Administration in Mexico Today*, Fondo de Cultura Economica y Secretaria de la Contraloria General de la Federacion, pp. 204 -206.

13. OECD (1997), *The OECD Report on Regulatory Reform: Synthesis*, Paris, p. 37.

14. OECD (1995), *Recommendation of the Council of the OECD on Improving the Quality of Government Regulation*, Paris.

15. Acuerdo para la Desregulacion de la Actividad noviembre de 1995, Empresarial (ADAE), Diario Oficial de la Federacion, 23 de noviembre de 1995.

16. Business formalities are procedures related to the authorisation and/or certification of business activities that involve the exchange of information between businesses and regulatory agencies, or rules that require businesses to conserve information for eventual review by regulatory authorities.

17. Acuerdo para la Desregulacion de la Actividad Empresarial (ADAE), p. 2.

18. The Comptroller General sent a letter to the deputy ministers responsible for regulatory reform to comply fully with their obligations relating to new regulatory proposals and regulatory impact statements.

19. OECD/PUMA (1998), Mexico's Responses to the Review Questionnaire on Competition Policy, p. 22.

20. Noyola, Pedro and Enrique Espinosa (1997), "Policy Competition and Foreign Direct Investment: The Case of Mexico", SAI Laws & Economics Paper, May, p. 38 -43.

21. Noyola, Pedro and Enrique Espinosa (1997), pp. 41-43.

22. See box on the contracting out of a municipal water system by a northern Mexican municipality in World Bank (1997) *The Private Sector in Infrastructure: Strategy, Regulation and Risk*, p. 11.

23. Morales Doria, Juan (1998), "The Role of Regulatory Reform/Deregulation. The Private Sector as Main Participant in the Deregulation Process", presentation to the APEC Regulatory Reform Symposium, August.

24. Consejo Coordinador Empresarial (CCE) (1999), *Estudio Comparative de la Calidad del Marco Regultorio en los Estados de la República Mexicana.*

25. It is worth to note that the NAFTA negotiations were not only external but also domestic. According to government data, more than 2 500 meetings were organised with the business, social and academic sector before and during the negotiations (Lopez Ayllon, S. (1995), p. 490).

26. Lopez Ayllon, S. (1995), p. 482.

27. Exemption from sanitary controls does not imply exemption from health or workplace safety standards.

28. SECODAM (1998), Programa "Usuario Simulado". Carpeta Ejecutiva. Coordinacion General de Estudios Especiales. June.

29. Ozorio de Almeida, Anna Luiza, Leandro F Alves, Scott E.M. Graham (1995), "Poverty, Deregulation and Employment in the Informal Sector of Mexico", Education and Social Policy Department, The World Bank, March, p. 18.

30. OECD (1997), *Economic Survey*, Paris, p. 72-73.

31. Ozorio de Almeida, A.L., Leandro F.A., Scott E.M.G. (1995).

32. The evaluation of this phenomenom is complex, in particular because of the definition of open unemployment in Mexico. However, from the end of 1990 to the end of 1994 (the time of the peso devaluation), all unemployment measures increased, while employment measures did not increase. For instance, in 1994 employment in non-maquiladora industries decreased 3.1 (see Figure 16 of the OECD (1997), *Economic Survey: Mexico*, Paris, p. 74, and OECD (1999), *Economic Survey: Mexico*, Paris, p. 30). Since 1996 this situation has markedly changed: nearly 3 million formal sector jobs were created, almost half in exporting companies and maquiladoras.

33. For instance, unemployment rates increased from 1991 to 1995. About the impact of rationalisation and the informal sector see Ozorio de Almeida, A.L., Leandro F.A., Scott E.M.G. (1995), pp. 14-15.

34. Tokman, Victor (1992), *Beyond Regulation. The Informal Economy in Latin America*, Lynne rienner Publishers, Boulder, London, p. 9.

35. Some studies have shown that the relationship between the size of the unofficial economy and the quality of the Rule of Law is strong and consistent and "countries with more corruption have higher shares of the unofficial economy." See Johnson Simon, Daniel Kaufmann, Pablo Zoido-Lobaton (1998), "Regulatory Discretion and the Unofficial Economy", *Goverment in Transition*, Vol.88, No. 2, p. 391.

36. Ozorio de Almeida, A.L., F.A.Leandro, E.M.G Scott (1995), p. 26.

37. Ozorio de Almeida, A.L., F.A. Leandro, E.M.G Scott (1995), p. 83.

38. In Fix Fierro, Hector (1998), "Poder Judicial" in Gonzáles, Ma. del Refugio y Sergio López Ayllón, eds. *Transiciones y diseños institucionales*, México, UNAM, (in press), p. 32.

39. The institution and term come from the colonial tradition where and individual could ask for "proteccion"(*amparo*) and shelter from abuses of power from the King. See also Fix Zamudio, Hector, (1965), "Sintesis del derecho de amparo" in *Instituto de Derecho Comparado, Panorma del Derecho Mexicano*, Mexico, UNAM, Vol. pp. 113 - 156. See also Lopez-Ayllon, S. (1995), p. 485.

40. However, *amparos* are not class actions – only the plaintiff is granted relief. Industry-wide or class-action suits for generalised regulatory correction do not exist in Mexico.

41. Plan Nacionl de Desarrollo, 1995 - 2000, Mexico, p. 20.

42. "Notes: Liberlismo contra Democracia: Recent Judicial Reform in Mexico", *Harvard Law Review*, 1995, Vol. 108:1919, pp. 1919-1936.

43. Tribunal Superior de Justicia del Distrito Federal (1997), "Justicios presentados en materia mercantil y civil, juzgados de Primera instancia del D.F. 1989-1997".

44. OECD (1998), *Environmental Performance Reviews: Mexico*, Paris, pp. 135-151 and Procuraduria Federal del Medio Ambiente (1998), Press Communication, Mexico, April.

45. OECD (1997), *Regulatory Impact Analysis: Best Practices in OECD Countries*, Paris.

46. Broder, E. John F. Morall III (1997), "Collecting Data and Using Data for Regulatory Decision-making" in *Regulatory Impact Analysi: Best Practices in OECD Countries*, Paris.

47. OECD (1997), *The OECD Report on Regulatory Reform: Synthesis*, Paris.

48. Lopez Ayllon, S. (1997), pp. 239-242.

49. For instance, the CRE has independence to grant concessions and permits in Natural Gas but COFETEL does not have such freedom an thus access decisions are subordinated to the Ministry of Communications and Transport. in Tovar Landa, Ramiro (1997), "Policy reform in networks infrastructure. The Case of Mexico", *Telecommunications Policy*, Vol. 21, No. 8, p. 731.

50. A series of financial reform proposals are been discussed in Congress since Spring 1998 aimed to give to the CNBV a higher degree of independence from the Finance Ministry, and even from the Executive.

51. See discussion in Tovar Landa, R. (1997), p. 731.

52. Noyola, Pedro, Enrique Espinosa (1997), p. 31.

53. Tovar Landa, Ramiro (1997), p. 731 and OECD/ DAFFE (1998), Note by Mexico. Mini-Roundtable on Relationship between Regulators and Competition Authorities, (DAFFE/CLP/WD(98)20), Paris, p. 6.

54. Ruster, Jeff (1997), "A Retrospective on the Mexican Toll Road Program (1989-94)", *Public Policy For the Private Sector*, World Bank, Note No. 125, p. 4.

55. Gil-Diaz, Francisco (1998), "The Origin of Mexico's 1994 Financial Crisis", *The Cato Journal*, Vol. 17, No. 3.

56. World Bank (1990), *Mexico Industrial Policy and Regulation*, pp. 23-28.

57. Business formalities are divided into two categories: voluntary and mandatory. Mandatory formalities include formalities that must be complied with by all businesses (certain tax requirement, official business registrations) and those that are obligatory for businesses in specific sectors or activities (regulations pertaining to transportation of dangerous substances, for example). Most mandatory business formalities are licenses, permits or authorisations. Voluntary formalities are usually related to a service or promotional programme provided by the government. The latter include duty draw-back schemes, rules of origin formalities or requests for the provision of electricity. A total of 2 940 federal business formalities have been reported to the UDE and the CDE, of which 2 147 (or 73%) were mandatory.

58. Schawrtz, Bernard (1984), *Administrative Law*, quoted in Guasch, J.Luis and Pablo t. Spiller (1997), *Managing the Regulatory Process: Design, Concepts, Issues and the Latin America and Caribbean Story*, World Bank, New Direction for Development series.

59. DTI (1998), *A Fair Deal for Consumers. Modernising the Framework for Utility Regulation*.