OECD Economics Department Working Papers No. 657

Maximising Mexico's Gains from Integration in the World Economy

David Haugh,
Roselyne Jamin,
Bruno Rocha

https://dx.doi.org/10.1787/230020040844

OECD

Unclassified **ECO/WKP(2008)65**

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development **17-Dec-2008**

English - Or. English

ECONOMICS DEPARTMENT

ECO/WKP(2008)65
Unclassified

MAXIMISING MEXICO'S GAINS FROM INTEGRATION IN THE WORLD ECONOMY

ECONOMICS DEPARTMENT WORKING PAPERS No. 657

By David Haugh, Roselyne Jamin and Bruno Rocha

JT03257651

English - Or. English

ABSTRACT/RÉSUMÉ

Maximising Mexico's gains from integration in the world economy

This paper discusses Mexico's foreign trade and investment policies and provides specific recommendations to enhance the benefits of a closer integration in the world economy. Over the past two decades, Mexico has made significant progress in reducing barriers to trade and foreign direct investment (FDI), and this has boosted GDP per capita growth. Nevertheless, Mexico needs to make further progress in reforming its trade policy by further reducing MFN tariff barriers and non-tariff barriers so as to promote efficiency in the economy. Barriers to FDI remain high, particularly in some services and infrastructure sectors, such as telecommunications and domestic land transport. Restrictions to foreign ownership should be eased to attract higher inflows and thereby improve productivity. To broaden the benefits from FDI, supplier linkages between FDI investors and other firms in Mexico should be enhanced.

This working paper relates to the *2007 Economic Survey of Mexico* (www.oecd.org/eco/surveys/mexico).

JEL classification: F1; F14; F21.

Keywords: Mexico; Trade Performance; Trade Policy; Foreign Direct Investment.

Tirer profit au maximum de l'intégration du Mexique dans l'économie mondiale

Le présent papier examine les politiques menées par le Mexique dans le domaine des échanges et investissements internationaux, et formule des recommandations spécifiques visant à lui permettre de tirer le meilleur parti possible d'une intégration plus étroite au sein de l'économie mondiale. Au cours des deux dernières décennies, le Mexique a sensiblement progressé dans la réduction des obstacles aux échanges et à l'investissement direct étranger (IDE), ce qui a favorisé l'augmentation du PIB par habitant. Cela étant, des progrès restent à faire sur le plan de la réforme de la politique commerciale, en réduisant encore les obstacles tarifaires et non tarifaires sur une base NPF, de manière à accroître l'efficience de l'économie. Les entraves à l'IDE demeurent nombreuses, notamment dans certains secteurs de services et infrastructures comme les télécommunications et les transports terrestres intérieurs. Il conviendrait d'assouplir les restrictions touchant les intérêts étrangers de manière à attirer davantage d'investissements et à améliorer ainsi la productivité. Pour tirer un plus large profit de l'IDE, il conviendrait de renforcer les liens logistiques entre les investisseurs étrangers et les autres entreprises présentes au Mexique.

Ce document de travail se rapporte à l'Étude économique du Mexique 2007 (www.oecd.org/eco/etudes/mexique).

Classifications : F1; F14; F21.

Mots clés : Mexique; performance commerciale; politique commerciale ; investissement internationaux.

TABLE OF CONTENTS

Boxes

MAXIMISING MEXICO'S GAINS FROM INTEGRATION IN THE WORLD ECONOMY

David Haugh, Roselyne Jamin and Bruno Rocha[1]

1. Since the mid-1980s, a cornerstone of Mexico's development strategy has been to gradually open the economy to foreign trade and investment. The opening of the economy has contributed to boosting GDP per capita and increasing integration with the rest of the world and, in particular, the United States. However, much remains to be done to promote further integration in the world economy and foster Mexico's convergence to the living standards of richer OECD countries.

2. Trade openness has created new opportunities as well as challenges for Mexican firms. They face increased competition domestically and in their key exporting markets. The challenge is to ensure that firms fully develop their potential in line with the economy's comparative advantages, move up the technological ladder and diversify export-oriented activities. This, in turn, requires improving overall framework conditions, enhancing human capital, promoting competition in the domestic market, and creating stronger incentives and better price signals for investment. Further trade liberalisation and foreign direct investment (FDI) regulatory reforms can play a key role in this context by giving easier access to higher quality production inputs at lower prices. They can also assist by ensuring that firms receive less distorted relative price signals for where to expand, increasing competition and encouraging greater returns to scale and by further promoting supply chain links and technological spillover effects between foreign and domestic firms.

3. Despite significant progress in liberalising trade and foreign investment, there is still room to make important improvements. Four main issues need to be addressed: *i)* the presence of relatively high Most Favoured Nation (MFN) tariff barriers that bias factor allocation towards low productivity sectors (Mexico's average MFN tariff remains above the average for middle-income countries and is becoming more relevant as trade with non Regional Trade Agreement (RTA) countries increases); *ii)* the complexity of trade policy settings arising from the combination of multiple regional trade agreements with different terms and different tariffs for RTA and non-RTA countries, which creates distortions and is expensive to administer; *iii)* relatively high non-tariff barriers, which shelter the economy from competition and reduce the cost-competitiveness of Mexican firms that use inputs affected by these barriers; and *iv)* barriers against foreign investment, which are still among the most restrictive in the OECD. As a consequence, despite Mexico's geographical location, FDI inflows, although still substantial, have declined over the past decade. The scale of FDI inflows in proportion to GDP is lower in Mexico than in some of the faster-growing middle-income countries (*e.g.* Chile, Hungary, Poland and the Czech Republic).

---

1. The authors would like to thank Andrew Dean, Bénédicte Larre, Stefano Scarpetta and Willi Leibfritz for comments and suggestions on earlier drafts. Our gratitude also goes especially to Nadine Dufour and Lillie Kee for secretarial assistance with this paper. Most of the data and analysis for this paper was collected and carried out prior to the release of the OECD *Economic Survey of Mexico* 2007 in September 2007. The constant market share analysis described in this paper was carried out in the first half of 2008 following the release of the *Survey*.

4. This paper discusses trade and FDI performance in Mexico over the past decade. It highlights progress achieved in trade policy and FDI regulatory reforms but also stresses the need for further coordinated policy action to promote trade integration and FDI flows. Greater trade and FDI flows, by encouraging a more efficient allocation of resources in the economy, allowing access to cheaper inputs and increasing competition are of key importance to lift productivity and living standards in Mexico.

Trade performance

The opening of the economy, and Mexico's integration with the United States

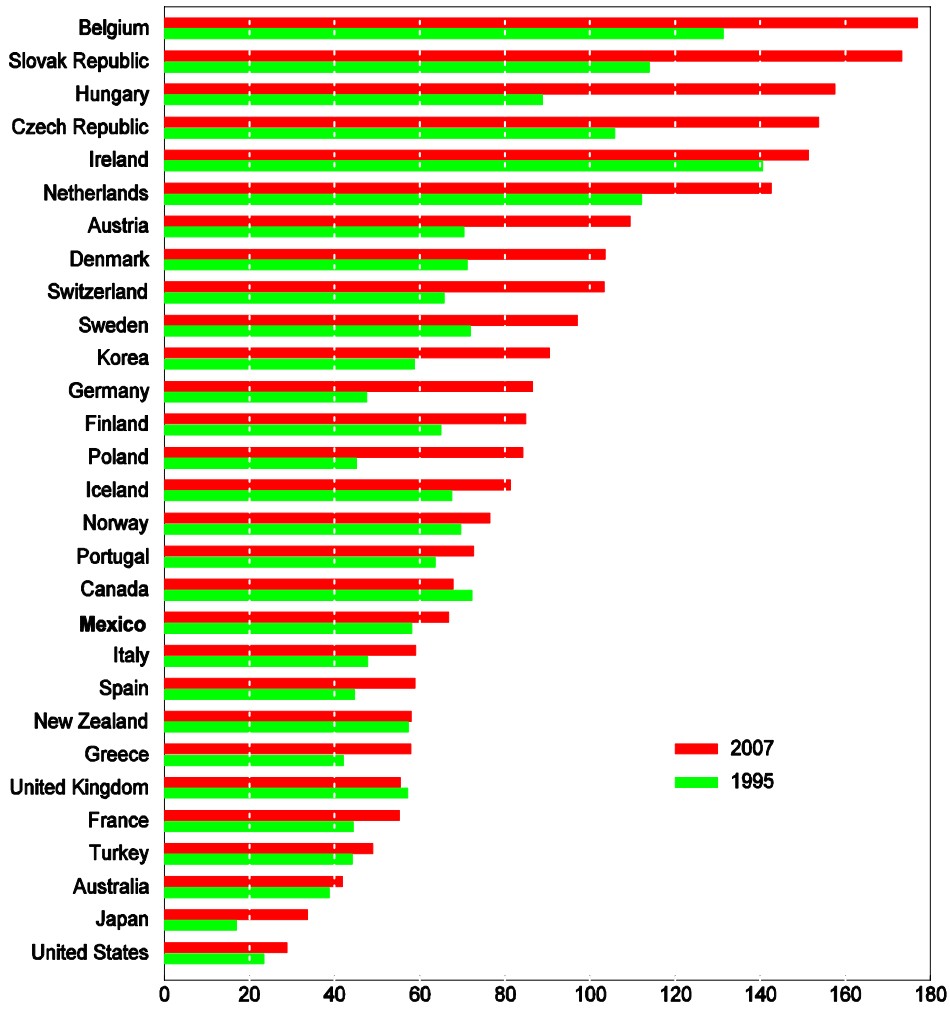
5. The process of external liberalisation in Mexico commenced in the 1980s. Restrictions on foreign investment were eased, trade policy was liberalised, and in 1986 Mexico became a member of the World Trade Organisation (WTO).[2] Mexico has also made significant progress in opening the economy to trade by lowering tariffs *via* 12 bilateral and multilateral RTAs, which at present include 44 countries, among which many of the most important players in world trade. Mexico's RTAs cover the United States and Canada (North American Free Trade Agreement (NAFTA), in force since 1 January 1994), the European Union (in force since 1 July 2000) and Japan (in force since 1 April 2005). With the opening of the economy, combined exports and imports have increased as a share of GDP from 39% in 1990 to 58% in 1995 and 67% in 2007 (Figure 1).

6. Trade with countries covered by RTAs accounts for the bulk of Mexico's trade (Figure 2, Panel A). The share of Mexico's exports going to RTA countries has expanded a little since 1994 when NAFTA came into force, while the share of imports from RTA countries has fallen, particularly that of the United States, indicating an increasing relevance of non-RTA countries in Mexico's trade. Figure 2, Panel B shows the change in share in each year that is due to new RTAs being signed, *e.g.* the Japan RTA in 2005.

2. Then known as GATT (General Agreement on Trade and Tariffs).

Figure 1. Trade-to-GDP ratio

Total goods and services as per cent of GDP, current prices



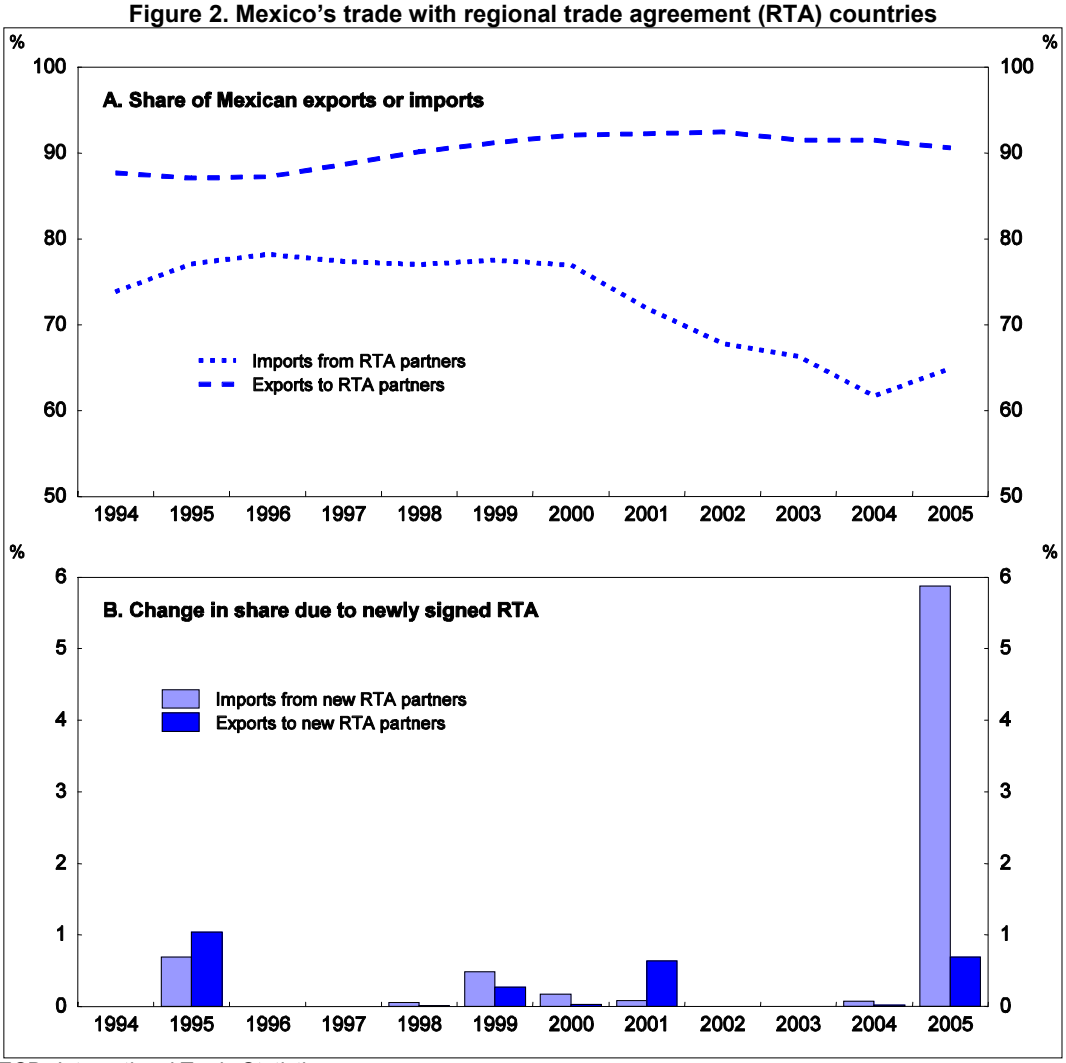
Source: OECD National Accounts.

7. The most significant RTA for Mexico is NAFTA, with the United States and Canada. NAFTA dramatically increased the size of markets available for free entry of Mexican goods and increased Mexico's exposure to import competition from the United States and Canada. Together, Canada and the United States accounted for 88% of Mexico's exports in 2005, and the United States alone accounted for over 85% of Mexico's exports. Export specialisation has developed in manufactured goods, which now account for over 85% of all goods exports, the main export categories being the automotive sector and electrical and television equipment (Table 1, Annex A2 and Box 1). Mexico's import sources are more diversified with only 56% of Mexico's imports coming from NAFTA partners.

8. Import penetration (measured as a share of domestic demand) has increased over the years, but at around 30%, it is still among the lowest in the OECD (Figure 3). Although this is broadly in line with the rate predicted by economic factors, such as per capita income, population and transport costs, import

penetration could increase further. For instance, OECD countries that have grown faster over the longer-term, including the Czech Republic, Korea and Ireland, have higher – and higher-than-predicted – import penetration rates (OECD, 2005e).

Figure 2. Mexico's trade with regional trade agreement (RTA) countries



Source: OECD, *International Trade Statistics*.

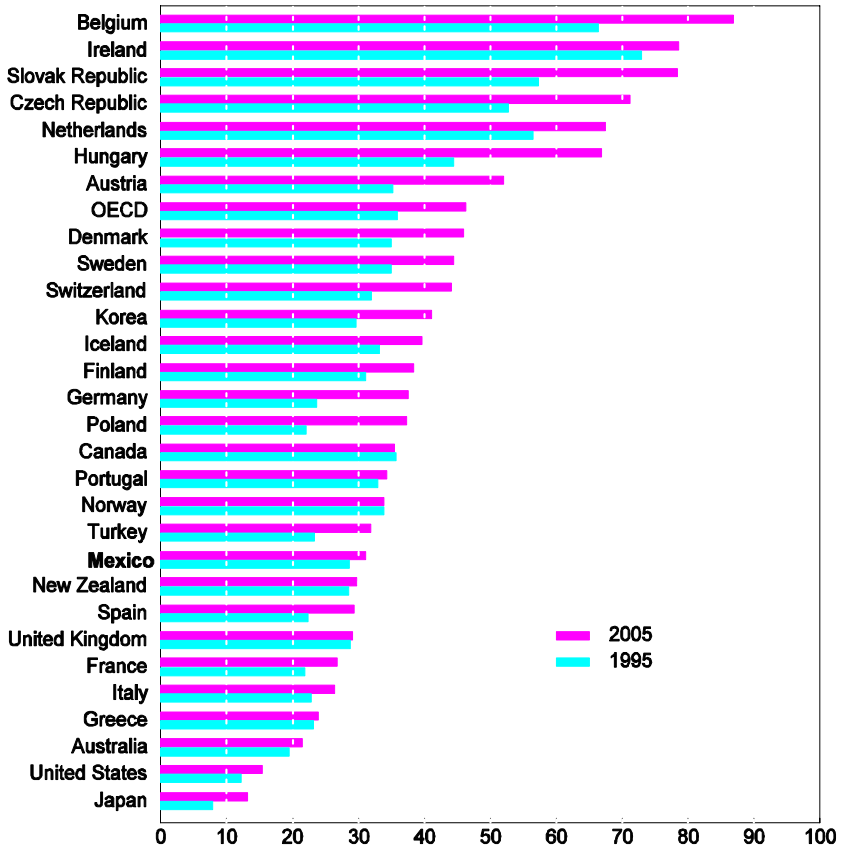
Table 1. Main categories of manufactured exports by value (average share 2001-2006)

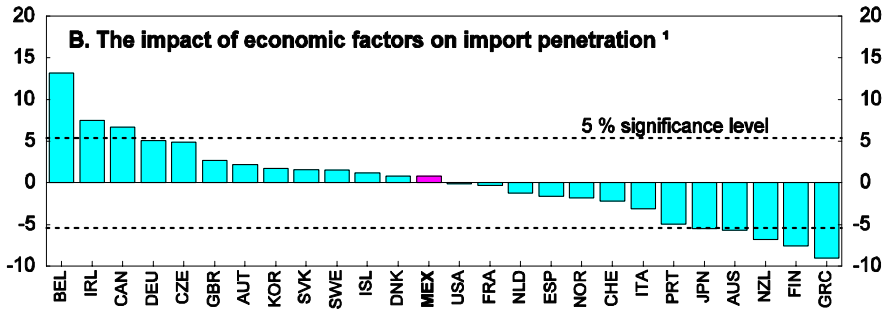
Sector	Percentage of manufactured exports
Transport equipment (primarily autos and auto parts)	20
Radio and TV equipment	14
Wires, cables, circuits and components	11
Computers and office machines	8
Electric motors and appliances	6
Clothing and footwear	6
Base metals	6
Chemicals, rubber and plastics	5

Source: OECD, *International Trade by Commodities Statistics.*

Figure 3. Indicators of trade integration

A. Import penetration rates for goods and services as per cent of domestic dem





1. Import penetration (1995-2005 average for goods and services) is estimated as a function of population, per capita income and transport costs. A negative (positive) residual indicates that import penetration is below (above) the level predicted by economic factors.
Source: OECD, National Accounts.

Box 1. The automotive sector in Mexico: its importance, evolution and challenges

The automobile industry is the largest branch of Mexico's manufacturing. In 2005, it accounted for 15.1% of manufacturing GDP, 13.7% of manufacturing employment[1] and close to 20% of manufactured exports. During the past decade, it has gone through several export phases, with vehicle and parts exports to the United States growing by 21% per annum on average from 1995 to 2000, before falling by 2% a year on average between 2001 and 2005. In 2006, following a period of re-tooling, vehicle and vehicle part exports grew by 26%. Part of the strong export growth in 2006 reflected the launch of new models. Developments in the industry suggest Mexico has a growing comparative advantage in auto manufacturing. In January 2005, the Ford motor company announced the shutdown of 12 of its US plants by 2012. At the same time it projected an increase of its operations in Mexico. Today Mexico is exporting a range of higher-value cars to the biggest markets in the world, while importing cheaper cars for its own domestic use.

Evolution

The development of the Mexican automobile sector has gone through periods of contrasting policies, from import substitution in the 1950s and 1960s, to export promotion in the1980s. The most important rules governing automobile exports are set out in NAFTA. In the case of new cars, NAFTA requires around 60% of the car to be produced in NAFTA countries for it to be exported from Mexico to the United States and Canada.

The establishment of factories in certain regions of Mexico over time has been determined by different factors. Initially, car factories were established near Mexico City where there was a large market. Later, the companies were established in the northern part of the country, close to in-bond industries (*maquiladoras*). There is evidence that this later localisation was due to productivity advantages rather than the industry seeking the lowest-wage regions. The more recent localisation of investments seems to be dictated by the systemic competitiveness that can be gained from the integration of car industries with large local supply chains. This is reflected in the increasing regional productive specialisation in the North, and two central areas of Mexico.

Challenges

One of the advantages that could be expected from FDI in the sector is the spillovers and linkages that it can potentially generate for the Mexican economy, specifically through the development of chains of suppliers. However, this has so far been limited in Mexico. The automobile sector has relied on large tier-1 suppliers from Canada, the United States or Mexico (direct suppliers to an auto manufacturer, often involved in design and manufacture, but not marketing of final products), but it has only developed limited linkages with small Mexican suppliers for tiers 2 and 3 (sub-contracting manufacturers to tier 1 not normally involved in design). To enter the production chain, smaller suppliers have to comply with high international standards of quality, and meet large production requirements. Up until now, low quality, limited flexibility and reliability, partly due to poor managerial skills, have been the main obstacles for smaller Mexican suppliers to develop and cluster with the car assembly plants. In this context, despite ongoing efforts, foreign direct investors have not been able to provide the training and managerial skills that small suppliers need. In many cases, small suppliers do not qualify to tender for business (because they don't have the volume of sales or necessary ISO quality ratings) and therefore cannot benefit from the knowledge that car factories can provide.

The challenge for Mexico is to continue to improve support strategies that will encourage a more integrated and deeper manufacturing base. There are multiple government policies aimed at helping small firms. To ensure that the policy mix is cost-efficient over the medium term, there needs to be greater coordination and systematic policy evaluation. For this to be possible, surveys and data collection about small firm performance have to be improved.

1. See www.indicadorautomotriz.com.mx/secciones.php?id–sec=3&next=2.

2. See OECD (2006b) for a review of current SME policies in Mexico.

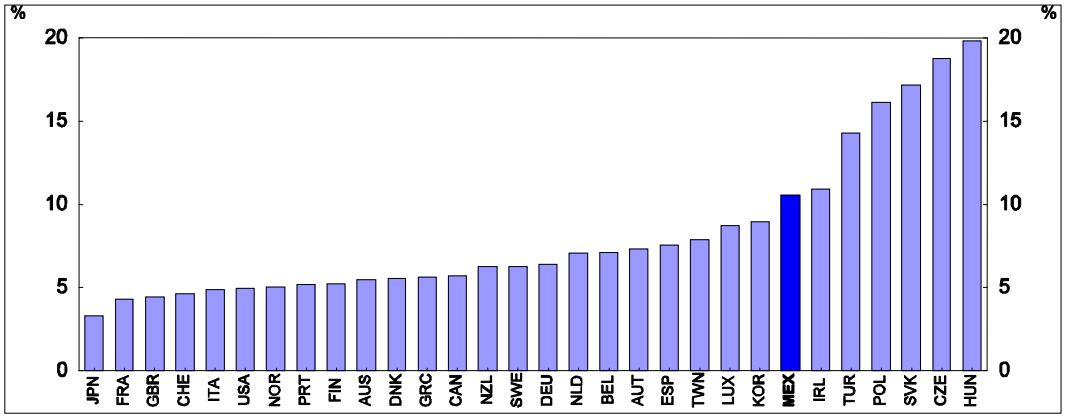
9. Mexico's geographical proximity to the United States has shaped its external performance and, together with NAFTA, led to increasing integration of the Mexican and US economies. Since 1994, the correlation between United States and Mexican annual GDP growth rates (based on a sample of the previous five years) increased from -0.17 in 1994 to 0.83 in 2005 before falling to 0.6 in 2007. A more diversified range of trading partners would help diversify the economy's exposure to shocks in the United States and contribute to enhancing macroeconomic stability in Mexico. Further liberalisation of

MFN tariffs would help this diversification by removing the current bias towards trading with RTA partners including the United States.

Mexico's export performance in manufacturing

10. Manufactured[3] goods exports, which account for the bulk of Mexico's goods exports, have expanded by 11% per year in dollar terms on average in the ten years to 2005, compared with 6% for the OECD on average (Figure 4). However, Mexico's results were below those of the strongest exporters among OECD countries (Czech Republic, Hungary, Ireland, Poland, Slovak Republic and Turkey).

Figure 4. Manufacturing export growth in comparison
Average annual growth rate, in current $, 1996-2005



1. Manufacturing is defined using the Harmonised System categories. For some countries the period is shorter due to unavailability of data.

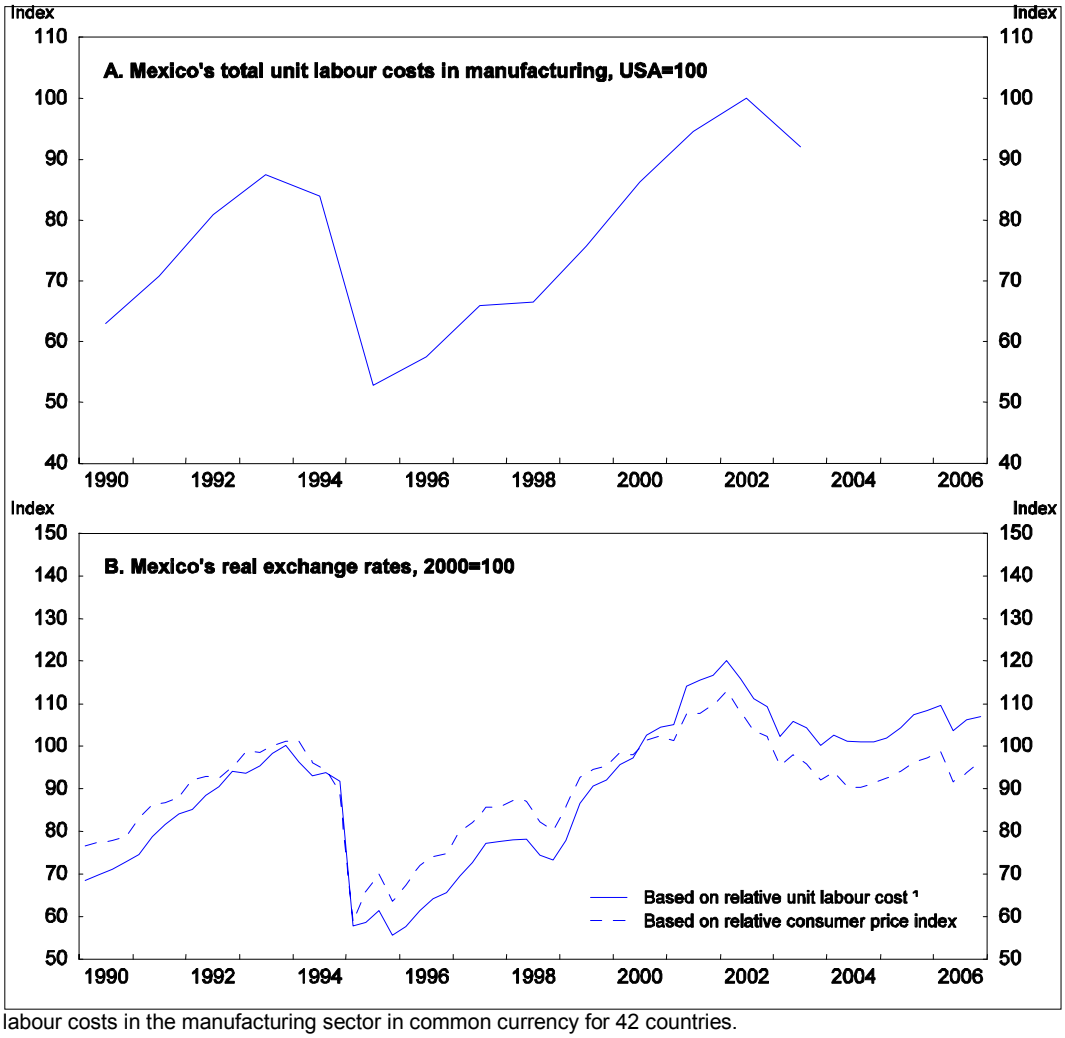
Source: OECD, *International Trade Statistics*.

11. The share of Mexico's exports of manufactured goods in world manufactured imports (values) increased from 1.5% in 1994 to 3% in 2000 and 2001, before slipping to around 2.3% where it remained from 2004-06. Mexico's favourable export performance from 1994 to 2000 resulted from a number of factors, notably the coming into force of NAFTA and the collapse of the domestic market at a time when the US economy was expanding, but also the large gains in cost competitiveness following the peso depreciation.

12. The subsequent phase of weaker performance and losses in market share occurred following a period of gradual real exchange rate appreciation (Figure 5). Chinese exports to the United States soared, and by 2005 China's share of United States manufactured imports had risen to 15%. All the major exporters to the United States, including Canada, also lost market shares over that period (Figure 6), with Japan suffering the largest losses.

3. Manufactured exports are chosen because they constitute the bulk of Mexico's exports and also because they are demand-driven and, therefore, market share performance is relevant. By contrast, a falling market share for commodities and agricultural goods may reflect Mexico's supply capacity rather than how well Mexico's firms are able to compete in the United States and other markets.

Figure 5. Real exchange rates



1. Unit labour costs in the manufacturing sector in common currency for 42 countries.

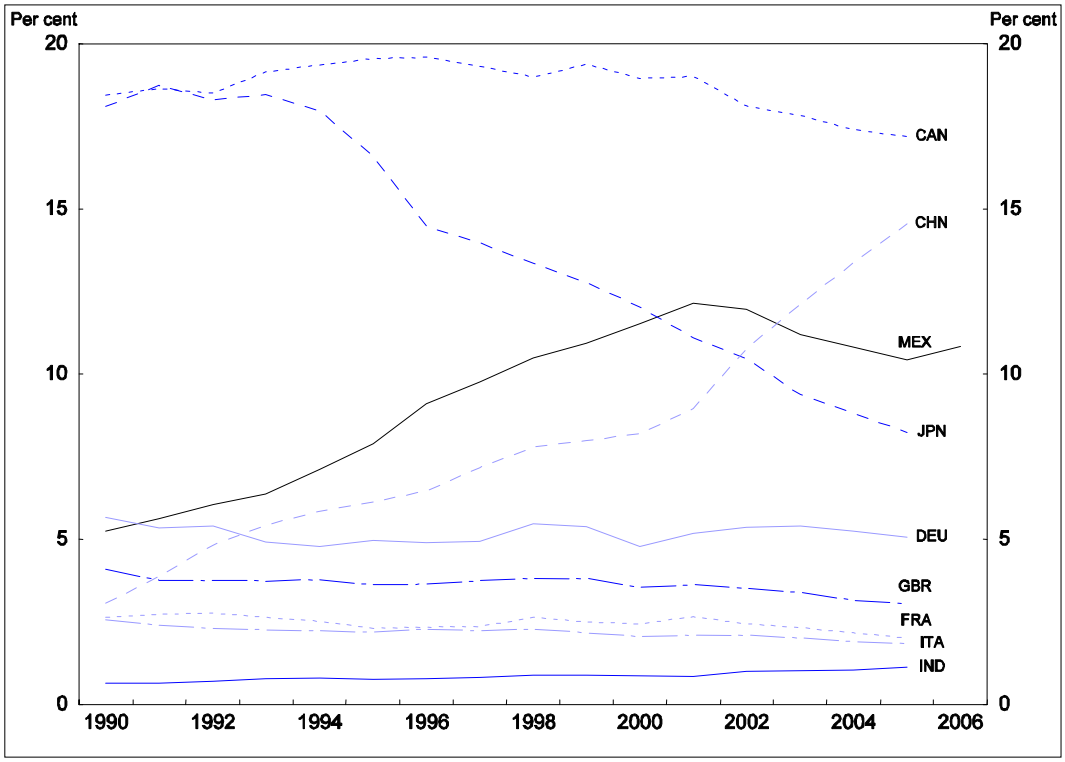
Source: OECD *Analytical* database, Groningen Institute.

13. In order to shed further light on factors behind the evolution of Mexican exports, a constant market share analysis (CMSA) is used to identify the important drivers by product and market of overall manufactured export performance in the United States and the rest of the world. International trade data classified on a harmonised system (HS) 1988 basis is used to group Mexico's manufactured exports into 24 product categories sold in two geographic areas (the United States and the rest of the world), allowing to distinguish 48 individual (product, geographic) markets.[4] Following the methodology in Cabral and

4. Because over 80% of Mexican exports are sold in the United States and all other countries (including Canada) individually represent only a very small share of Mexican trade, two geographic markets, the United States and the rest of the world, are used in the analysis. Many countries do not provide data for either a sufficiently long period or there are missing values in various years. The rest of the world is a proxy rest-of-the-world market that includes the 29 OECD members other than the United States plus 13 other major markets: Brazil, China, Chinese Taipei, Hong Kong, India, Indonesia, Malaysia, Philippines, Romania, Saudi Arabia, Singapore, South Africa and Thailand. These 42 markets together with the United States accounted for around 90% of all world trade in manufactured goods in 2006. For some of the non-OECD countries missing values were replaced with interpolated data.

Soares-Esteves (2006), the analysis is used to break down the percentage change in total market share into three main components.

Figure 6. Market share of selected countries in US manufactured imports



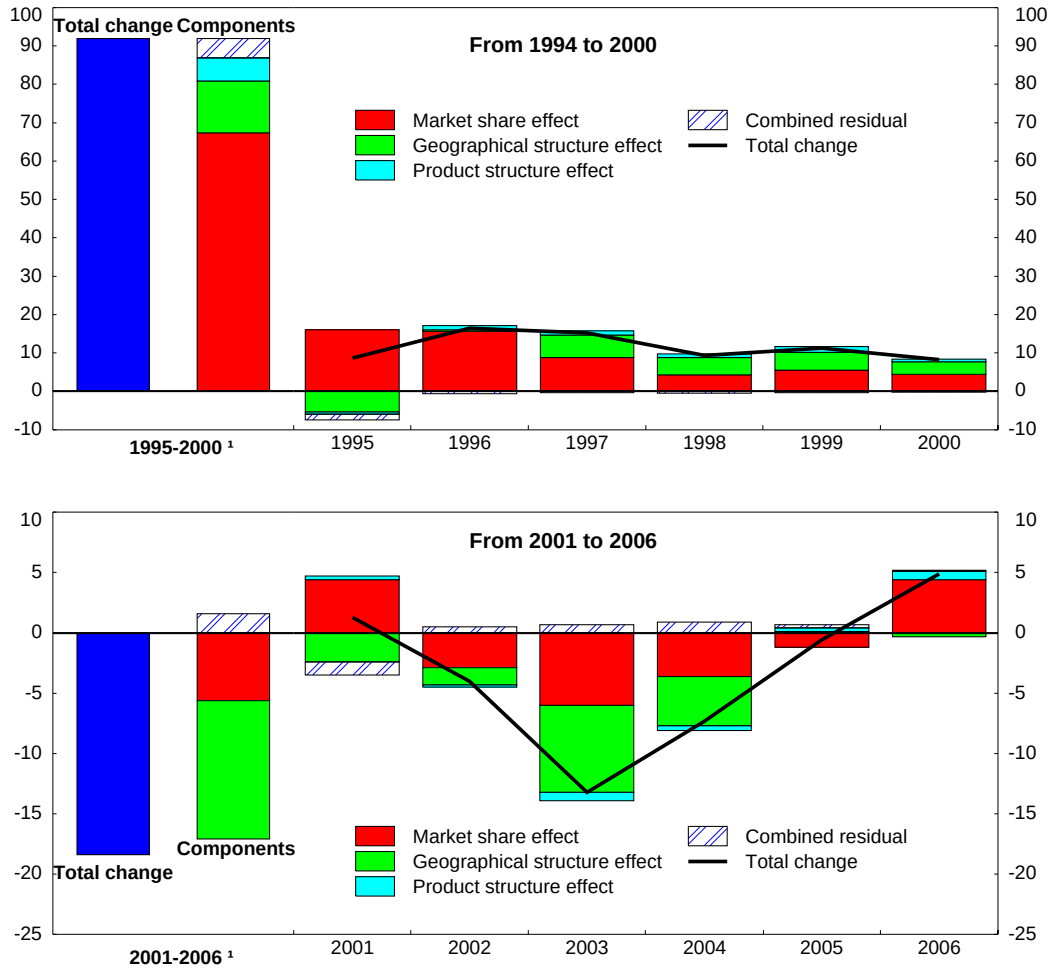
Source: US Customs Services.

14. The first component is the contribution of the change in market shares in each of 48 individual markets to the total market share change. (market share effect). This component is the sum of the change in market share in each market (product i to destination j) weighted by the share of that market in total Mexican exports. It excludes the effect of Mexico's relative geographical and product specialisation and measures how well Mexican exports are performing in each of their individual markets. It is a measure of export performance and is influenced by factors such as cost-competitiveness, consumer preferences, technological developments, product quality and the intensity of inter-firm competition in the destination market.

15. The second component is the part of the total change in market share that results from the geographical specialisation of Mexican exports (geographical effect). The final component is the product structure effect, which is the contribution of the product specialisation of Mexican exports. Overall, geography and product effects will be positive (negative) if Mexico is specialised in fast (slow)-growing geographical areas or products relative to the world average. The contribution of a single geographical area or product to the geographical and product structure effects respectively will be positive (negative) if that geographical area or product grows faster (slower) than average world import growth and the size of the contribution will depend on the relative specialisation of Mexico in that product or geographical area (the weight). For example, because Mexico is highly specialised in exporting to the United States, a small difference in the gap between US and world import growth will make a relatively large contribution to the change in overall market share (Annex 3.A1 sets out this methodology in more detail).

16. The CMSA analysis shows that from 1994 to 2000 Mexico's share of the world market for manufactures rose by 92% (Figure 7, Table 2). Two thirds of this was due to the market share effect, i.e. Mexican products were able to gain market share in each of their individual markets. Mexico also benefited from its strong specialisation in the United States market in this period with US import growth outstripping the world average and geographic specialisation contributing 14 percentage points of the total change. Mexico's product mix was also favourable, contributing 6 percentage points to the total change in world market share. In 2001 export performance weakened significantly and market share began to shrink in 2002. Over 2001-06, Mexico's share of the world market fell by 18.4%. The biggest contributor to this performance was geographic specialisation, which accounted for 14.4 percentage points of the decline, owing to slower US import growth than the world average. Product specialisation did not contribute to the change in market share, while the market share effect subtracted 5.6 percentage points.

Figure 7. Breakdown of change in total market share of manufacturing exports



1. The total change in market share and components is not always exactly equal to the sum of the annual changes.
Source: OECD, International Trade Statistics.

Table 2 Arithmetic breakdown of the total change in Mexican export market shares

	Total change	Market share effect	Combined structure effect	*of which:* Geographical structure effect	Product structure effect	Mixed structure effect	Residual
1994	1.3	1.3	0.3	-1.3	0.7	0.9	-0.3
1995	8.6	16.1	-5.9	-5.4	-0.6	0.1	-1.6
1996	16.5	15.6	0.8	0.5	1.0	-0.8	0.2
1997	15.2	8.8	5.8	5.9	1.0	-1.0	0.6
1998	9.4	4.3	4.9	4.5	1.0	-0.6	0.1
1999	11.3	5.5	5.9	4.7	1.5	-0.2	-0.1
2000	8.2	4.5	3.5	3.2	0.7	-0.4	0.2
2001	1.3	4.4	-2.5	-2.4	0.3	-0.4	-0.7
2002	-4.0	-2.9	-0.8	-1.4	-0.2	0.8	-0.3
2003	-13.2	-6.0	-7.5	-7.2	-0.7	0.5	0.2
2004	-7.3	-3.6	-3.7	-4.1	-0.4	0.8	0.1
2005	-0.6	-1.2	0.7	0.1	0.3	0.4	-0.1
2006	4.9	4.4	0.3	-0.3	0.7	-0.1	0.2
1994-2000	91.9	67.4	15.7	13.5	5.9	-3.7	8.8
2001-06	-18.4	-5.6	-11.5	-14.4	0.0	2.9	-1.3

Source: OECD Calculations, OECD International Trade by Commodity Statistics.

17. Annex A2 Table A2.3 shows the contributions to the market share effect and gives an indication of how well Mexican products are performing in their individual markets (product/geographic, *e.g.* exports of clothing to the rest of the world). Exports of four products to the United States, clothing and footwear, computers and office machines, radio equipment, and autos made the largest contributions to the positive market share effect from 1994 to 2000. Over 2001-06, the performance of these products exported to the United States deteriorated and they made the largest negative contributions to the market share effect. The performance in other individual markets with a lower share of Mexican exports did not deteriorate as uniformly. Although there was also a deterioration in performance between 1994-2000 and 2001-06 for 17 out of the remaining 20 product groups exported to the United States, 11 out of the 24 product groups exported to the rest of the world saw improved or equal performance between 1994-2000 and 2001-06. This suggests that individual market effects, including the intensity of competition between firms in the destination market, product cycle effects and changes in consumer preference can play a large role. For example, a recent shift in consumer preference to smaller vehicles in the United States has benefited Mexican auto exports, as Mexican production is relatively specialised in this type of vehicle.

18. Breaking down the product structure effect (Annex A2 Table A2.4) reveals that faster-than-average market growth in four products – computers and office machines, radio equipment and circuits and components and wires and cables – were responsible for most of the 5.6 percentage point contribution to market share gain in 1994-2000 arising from Mexico's product specialisation. In 2001-06, the largest positive contributors to the product structure effect, which overall was neutral, were in TV equipment and base metals, where the technological jump from CRT to LCD and plasma flat panel TVs and strong growth in emerging markets respectively meant that the world imports of these products grew more quickly than average. The largest negative contribution arose from computers and office machines, where world import growth slowed significantly between 1994-2000 and 2001-06, falling below the world average.

19. Examining the geographical effect (Annex A.2 Table A2.5) shows that Mexico's strong specialisation in exporting to the United States helped to boost its share of the world market from 1994 to 2000 and then contributed negatively to market share during 2001-06, reflecting the fact that US imports were growing faster than world imports in the mid to late-1990s but more slowly as from 2001.

20. Overall, Mexico's exports performed strongly in the world market in 1994-2000, particularly owing to a large rise in market share in the United States following NAFTA. Mexico's share in the rest of the world also rose. Weaker performance in the world market in 2001-06 was particularly driven by slower US import growth relative to world import growth, but also weaker performance in the United States market itself. Indeed, there was a larger fall in the market share effect (excluding the effects of geographic and product specialisations) between 1994-2000 and 2001-06 in the United States than in the rest of the world, where the market share effect was still positive. This suggests that the increasing entry of emerging market firms in the United States was generating particularly intense competition for Mexican firms exporting to the United States market in 2001-06 (Annex A2, Table A2.3).

21. Although recent evidence suggests that Mexico's export performance may be strengthening again, stronger competition from emerging economy firms means that the situation remains fragile. Mexico needs to adapt continuously to changing comparative advantages arising from new technologies and new market entrants.

Strengthening Mexico's externally-led growth performance

22. Empirical evidence supports a positive and strong connection between trade and growth.[5] Mexico's openness-led growth strategy has resulted in a solid growth performance for a period of over ten years, with Mexico experiencing only a small recession in the early 2000s due to a recession in the United States. Further improvements to both trade and FDI policies would improve Mexico's adaptability and magnify the gains from integration in the world economy. Reducing tariffs would improve the ability of Mexican firms to compete in foreign markets by ensuring they can access the best value inputs from anywhere in the world at the lowest possible cost. It would also remove the relative price distortions and bias towards low-productivity industries. The removal of the wedge between MFN tariffs and RTAs would eliminate trade diversion (Box 2) and the bias against trade with Asia. Although the share of non-RTA imports has been growing, it would most likely have grown faster without the current level of tariffs. There is a potential for Mexico to source more cheaper intermediate inputs in Asia for exports to the rest of North America, as well as to purchase cheaper Asian consumption goods.

23. The increase in trade, investment and growth that Mexico could experience from lowering its trade barriers is potentially large. Such action would signal to firms and investors that Mexico is a production base from where they can access inputs at the lowest cost and at the same time have free trade access, *via* existing RTAs, to some of the largest markets in the world, including the United States, Canada, the European Union and Japan. The increase in foreign trade and investment would contribute to productivity gains *via* increased competition and greater production scales that would encourage greater innovation in products, services and processes. On balance, the empirical literature supports a positive link between trade and growth (Ahn and Hemmings, 2000). Equations estimated across a panel of OECD countries indicate that an increase in trade openness of 10 percentage points of GDP (combined measure of export intensity and import penetration) would raise output per working-age person by 4% (OECD, 2003).

5. Winters (2004) reviews a wide body of literature and concludes that trade openness raises incomes.

Box 2. Trade diversion, productivity and employment

The combination of relatively high protection of low-productivity sectors and bilateral trade agreements can lead to the expansion of such low-productivity sectors and trade diversion. Trade diversion occurs when two economies have lower tariffs between them than with the rest of the world, leading to trade between them increasing at the expense of more efficient trade with other economies outside the trading bloc. For the importing economy this results in higher import costs and for the exporting economy it can result in the expansion of low-productivity sectors that drag down overall productivity performance and growth.

Evidence suggests that trade diversion has almost certainly occurred to some degree in NAFTA, especially in the clothing industry. The creation of NAFTA, together with high US and Mexican external import barriers for clothing, created a strong bias towards US imports from the Mexican clothing sector, which is labour-intensive and has lower labour productivity than other parts of the economy. This led to a large expansion of the sector in Mexico, with employment growing and Mexico posting large market share gains in the United States in the 1990s, while the Asian market share was falling. But the adjustment of Mexico's sector was only postponed. During the early 2000s, as the United States began to reduce its barriers to imports of clothing from the rest of the world markets and imports from other countries into the US grew, Mexico's market share fell.

Although the expansion of the clothing sector helped absorb part of the rapidly growing workforce in the non-farm sector, it is also one of the reasons why Mexico's productivity growth performance has failed to match that of other middle-income countries. It is important to create enough employment to absorb the very rapid increases in the labour force, but increased employment in low-skilled protected sectors, such as the clothing industry, is only a short-term, second best, solution. As the experience of the clothing industry illustrates, continued protection will maintain or increase jobs in low-skilled industries only temporarily, postponing the adjustment. Sooner or later, developments beyond Mexico's control, such as trade policy in other countries, technology changes and structural measures in other countries that improve the cost competitiveness of foreign firms, will eventually put pressure on the industry and lead to job losses.

Hence, Mexico should move ahead to gradually reduce protection in favoured industries, while at the same time ensuring that adequate retraining programmes are available for displaced workers with temporary income support if appropriate. Raising human capital is the only way to ensure sustainable higher productivity employment growth in the long run.

24. Higher trade growth would also contribute to productivity gains by increasing R&D spillovers from trading partners. International spillovers from R&D are potentially large. There is evidence showing that the level of foreign R&D in trading partners is an important explanatory factor in total factor productivity and that this increases with the openness of the country (Helpman and Coe, 1995). By increasing FDI from the United States and other developed countries, Mexico can benefit from their R&D efforts and raise its productivity growth. Indeed, labour productivity of foreign affiliates tends to be substantially higher than the national average in both the manufacturing and services sectors in OECD countries. This is the case in particular for lower-income OECD countries, such as the Czech Republic, Hungary and Portugal (OECD, 2005e).

25. For the gains from trade and FDI to materialise, a range of complementary structural reforms must be carried out to improve the business environment (Box 3). These reforms, discussed in the *OECD Economic Survey of Mexico, 2007*, include strengthening competition, improving infrastructure, developing human capital and facilitating labour market adjustment. Progress in these areas would contribute to lifting productivity and GDP per capita growth and help to further develop trade and FDI flows.

Box 3. Policy complementarities and trade and investment

Trade liberalisation contributes to higher output by encouraging the allocation of resources from less to more productive sectors and this process requires complementary policies, including improving the business environment, promoting competition and firm expansion. In Mexico there was a large reallocation of labour across sectors in the 1990s, but it has not always been to more productive uses. For the re-allocation of resources to raise productivity requires that the business environment be conducive to the survival and expansion of successful firms. In Mexico, firm entry is easy and entry rates are high but so are extinction rates and compared with other countries, only a few of the surviving firms expand rapidly (Pages *et al.*, 2007). The World Bank *Investment Climate Survey* suggests that factors of importance for encouraging firm growth include improving access to finance, reducing corruption and strengthening the rule of law.

There are important complementary policies that should accompany the reduction of tariff and FDI barriers. Cross-country estimates show that a wide range of policy variables, including reducing product market regulation (PMR), increasing domestic competition and improving the quality of the overall infrastructure, all help to boost trade and investment (Nicoletti *et al.*, 2003). These are shown to have the greatest effect on FDI flows, then on services trade, followed by goods trade. Specifically, OECD estimates indicate that easing PMR would boost Mexico's total exports by more than 20% (OECD, 2005).

Chang *et al*. (2005) also find that the effect on economic growth of greater openness depends on the progress made in other policy areas. In line with Pages *et al.*'s (2007) findings on the reallocation of resources associated with trade liberalisation in Latin America, the authors' results suggest that an increase in openness could even have a negative impact on growth if reforms in some complementary area is not sufficiently advanced. Using growth regression specifications that allow for interactions between trade openness and other policy areas, they find that the coefficient on the interaction between the trade volume ratio and, in turn, the secondary enrolment rate (the proxy for human capital), the private domestic credit ratio (financial depth), and the number of phone lines per capita (infrastructure) is positive and significant. The estimated coefficients on the interaction between the trade volume ratio and, in turn, the proxies for governance, labour market flexibility, and firm-entry flexibility are also positive and statistically significant. This is to say that a country cannot reap all the benefits of trade liberalisation if, for example, new and more efficient firms are prevented from entering the market because of entry restrictions, or if the labour market is too rigid. Trade openness may improve the incentive structure for resource re-allocation, but the extent to which resources move from less efficient to more efficient sectors depends on the degree of flexibility of factor markets (Dennis, 2006).

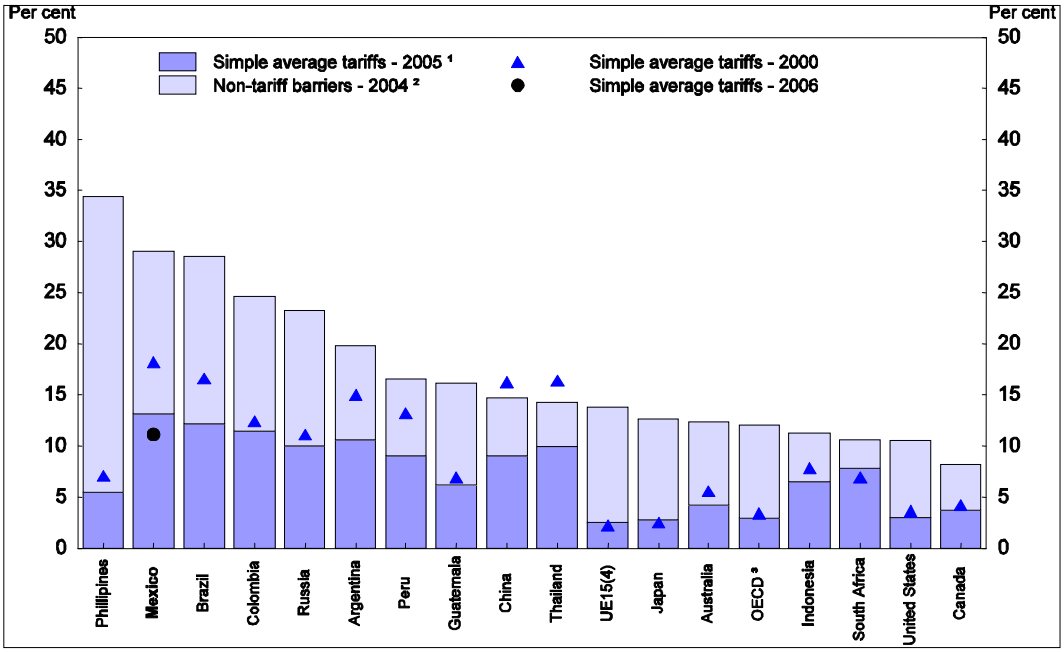
For Mexico to get the full benefit from trade liberalisation, it must take a comprehensive approach to reform. Already in 1956 Lipsey and Lancaster noted, in their "General Theory of Second Best", that piecemeal reforms are likely to fail and can even generate social welfare losses. The experience of OECD member countries shows that there are strong complementarities between structural reforms. Work done in the context of the OECD's *Going for Growth 2005* emphasises the importance of consistency across policy areas. For example, it shows that restrictive product market regulation (PMR) and selected restrictive labour market policies are positively correlated. One explanation for the observed correlation is that once one reform is carried out this creates pressure for, and removes obstacles to, reform in other areas. Because PMR reform reduces rents accruing to firms, they will find it less easy to bear the cost of restrictive employment protection legislation (EPL). Furthermore, workers may have less incentive to protect their jobs through EPL because of greater alternative employment, as lower PMR is found to increase employment opportunities (Nicoletti and Scarpetta, 2005). There is also a cross-country correlation between barriers to trade and investment and domestic barriers to competition and this may reflect a political economy effect whereby openness to trade and international investment generates pressures for domestic policy reform (OECD, 2005d). At a general level, the likelihood of reform in one area is increased by over 5% when reforms in other areas have already been implemented (Duval and Elmeskov, 2005).

The opportunity created by carrying out a reform that facilitates others is one that should be seized because of the synergies these complementary reforms can have on growth. Oliveira Martins and Price (2000) discuss the importance of implementing policies together as far as possible to ensure that an economy moves to a higher growth path. *Going for Growth 2006* shows how framework policies – education policy, financial market policy, openness to FDI as well as product and labour-market regulation – all contribute to influencing innovation efforts and performance. If not enough progress is achieved in some areas, for instance, education or labour market regulation, then the benefits derived from more open product markets on innovation and growth may be diminished or not materialise at all. Policies are mutually interdependent, and ensuring coherence between policy areas is essential.

Trade policy: further reducing tariffs and non-tariff barriers

26. According to a synthetic indicator of the restrictiveness of trade policy, which takes into account both applied MFN tariffs and a tariff equivalent of non-tariff barriers, Mexico had a more restrictive trade policy in 2005 than the OECD average. In particular, the restrictiveness was higher than in its trading partners in NAFTA, the United States and Canada (Figure 8). It was also higher than in less advanced countries such as South Africa, Argentina, Colombia, Guatemala, Peru and China. Overall, Mexico's tariffs in 2005 were still above the middle-income country average. The 2006 reduction in tariffs, however, may have changed Mexico's relative position somewhat. Non-tariff barriers in Mexico are also among the higher ones in the sample, far above those in other OECD countries or those in many developing countries.

Figure 8. Total trade barriers (tariff and non-tariff) in comparison



1. MFN average tariff (simple average, *i.e.* not import weighted).
2. Tariff equivalent of non-tariff barriers (simple average).
3. OECD does not include Korea, Luxembourg and the Slovak Republic.
4. EU15 minus Luxembourg.

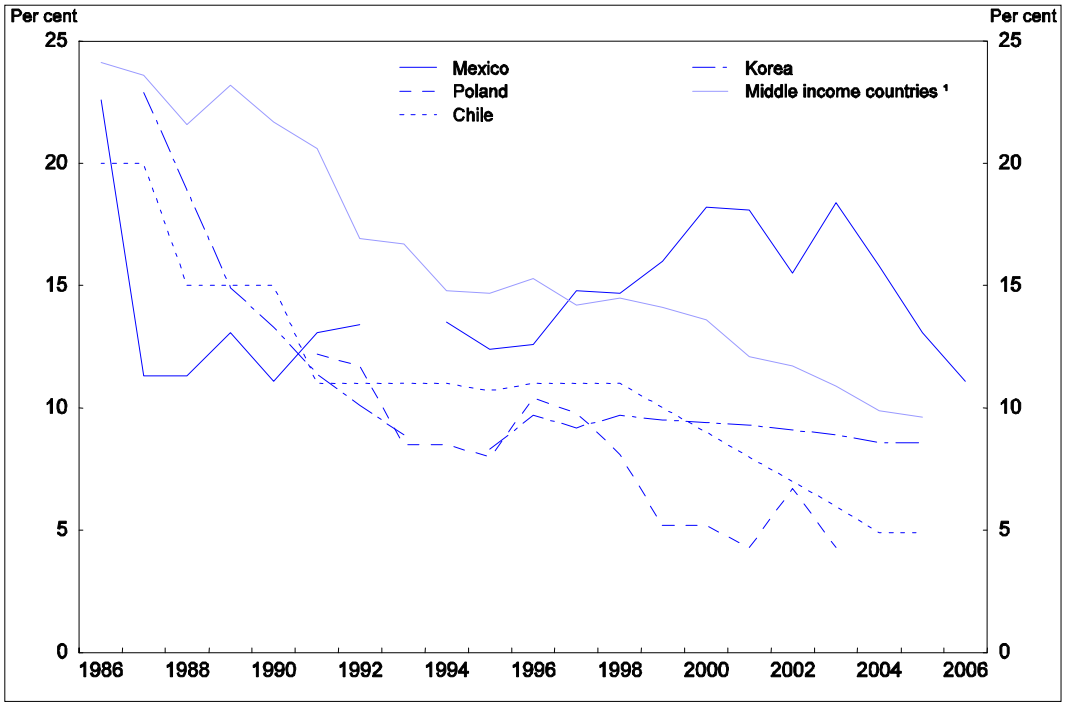
Source: UNCTAD's *TRAINS* database; World Bank Data on trade and import barriers; Kee *et al*. (2005); and OECD.

Despite the reduction in tariff barriers the risk of trade diversion remains…

27. As well as liberalising trade through RTAs, Mexico has made progress in reducing tariff barriers on a multilateral basis. In line with trends in other countries, Mexico's MFN tariff barriers fell substantially after 1986, when Mexico joined the GATT/WTO. However, in the second half of the 1990s and early 2000s, Mexico was the only OECD country to raise its average unweighted applied MFN tariff (Figure 9). These increases were, at least partly, made for fiscal reasons, and therefore broad-based, close to 90% of tariff lines being affected in the January 1999 increase (WTO, 2002). At the same time, other middle-income countries continued to reduce their trade barriers. Mexico has since resumed tariff cuts, with particularly broad ones in December 2004 and September 2006,[6] but there is still some way to go to bring its average tariff down to levels prevailing in the OECD – or even in non-OECD middle-income countries.

6. The 2006 cuts were particularly aimed at cutting the costs of Mexican producers by reducing the cost of imported intermediate inputs.

Figure 9. Applied tariff rates: 1986 to 2006
Average unweighted applied tariff rates



1. 86 countries.

Source: World Bank and OECD.

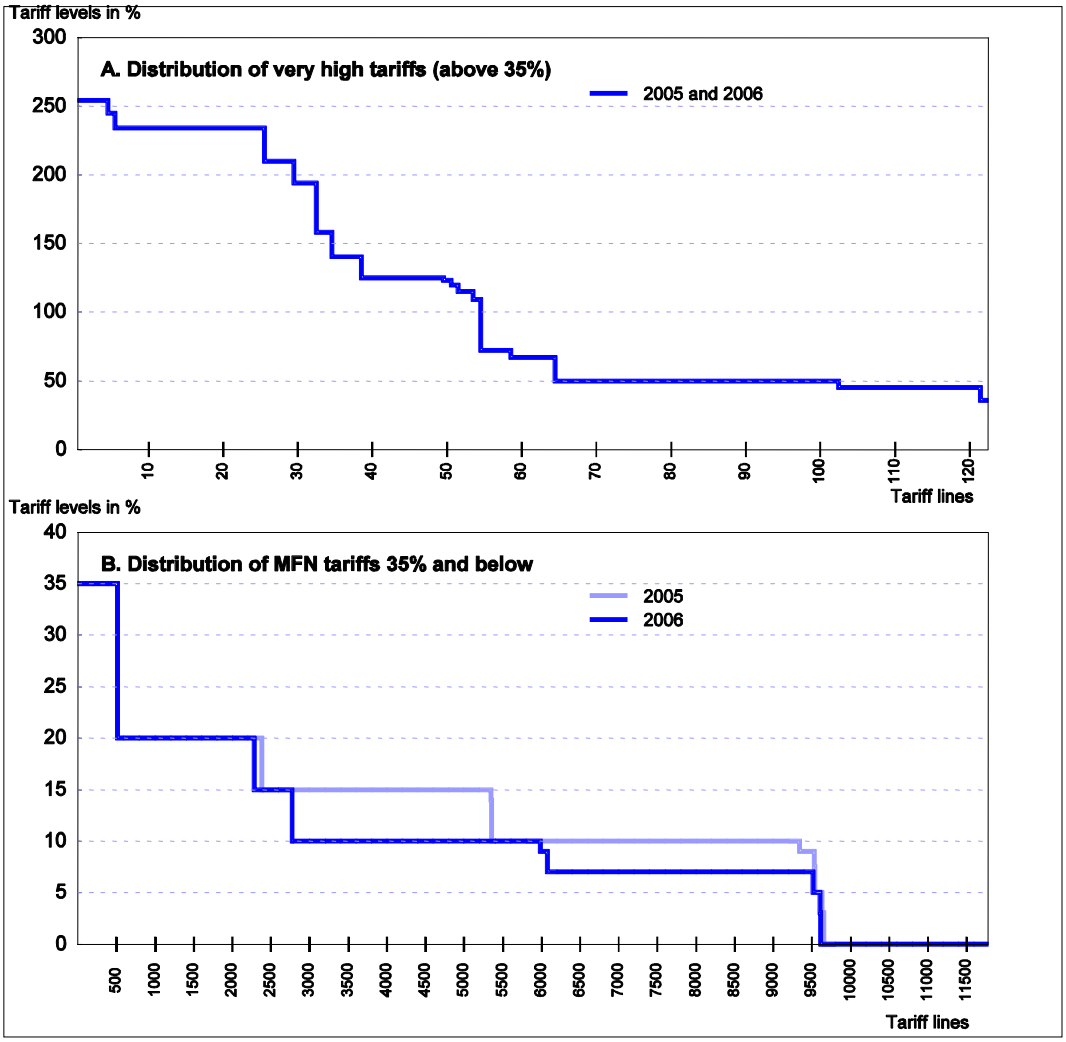
28. As noted, a significant feature of Mexico's trade policy regime from a tariff perspective is the significant liberalisation of its trade *via* the various RTAs signed since the early 1990s. The ensuing opening of the Mexican economy has had significant benefits. However, these RTAs have created the potential for trade diversion, owing to the wedge between the MFN tariff and the tariffs that apply to RTA countries. In 2003, Mexico's simple (*i.e.* not import weighted) average tariff for RTA countries was 2.2%. This was significantly below the MFN average tariff for non-RTA countries of 18.4%. MFN tariff cuts at the end of 2004 and in 2006 have narrowed the gap between the average MFN and RTA tariffs, but it is still significant. Of particular concern is that, because the RTA tariff is much lower than the MFN tariff and Mexico does not have RTAs with East Asia (except Japan), the current trade policy settings discriminate against imports from East Asia, which are potentially a source of low-price manufactured inputs for firms located in Mexico.

… and tariffs are biasing resource allocation towards low productivity sectors.

29. Following the September 2006 tariff reductions, Mexico's simple average applied MFN tariff fell to 11.1% (based on a total of 11 900 tariff lines). Figure 10 shows the distribution of tariffs by level. In terms of level distribution, there are three broad groups. First, a very small, highly-protected group of products, representing 121 tariff lines (1% of the total), has tariffs in excess of 35%, with almost half of the lines in this group having tariffs exceeding 100%. There is a second group of favoured products with above-average tariffs in the range of 15-35%, representing 2 774 tariff lines (23% of the total). The remaining 80% of tariff lines are at 10% or below, with 18% of the total number of tariffs being at zero.

30. The overall trade weighted average MFN tariff is almost identical in value to the simple average MFN tariff.[7] Approximately 80% of imports are in categories that have a tariff of 10% or below, 15% of imports are in categories that have a tariff of between 15-35% and 5% of imports are in product categories with tariffs over 35%. These import shares are themselves affected by the tariff levels, *e.g.* a cut in tariffs for products in the 15-35% range would lead to greater imports and a higher share of these products in total imports.

Figure 10. Distribution of Mexico's tariff levels



Source: World Bank *World Integrated Trade Solution* (*WITS*) database; UNCTAD; Mexico Ministry of Economy; OECD.

31. The highly protected group of products with applied tariffs between 36 and 254% is dominated by agricultural products, including poultry, sugar, corn, beans, coffee, grapes, malt, wheat, barley, tobacco and milk. Certain types of motor vehicles also feature in this group, with a tariff of 50%. In response to the rapid and large increases in the world price of some basic food products, the government cut tariffs in May 2008 on some food products, most notably on corn, for which the tariff was cut from 194% to 0% but also on other products including milk powder, for which the tariff was cut from 125.1% to 63%. There were

7. In 2005 the simple-weighted tariff was 13.1%, and the trade-weighted average tariff 12.7%.

also cuts to the tariff on some rice and wheat categories. These cuts will help ensure Mexican consumers pay lower prices for these products, and assist in reducing other structural problems such as trade diversion associated with the large wedge between MFN tariffs and tariffs faced by RTA partners. It would be desirable to make these changes permanent and go further in reducing tariffs (Box 4).

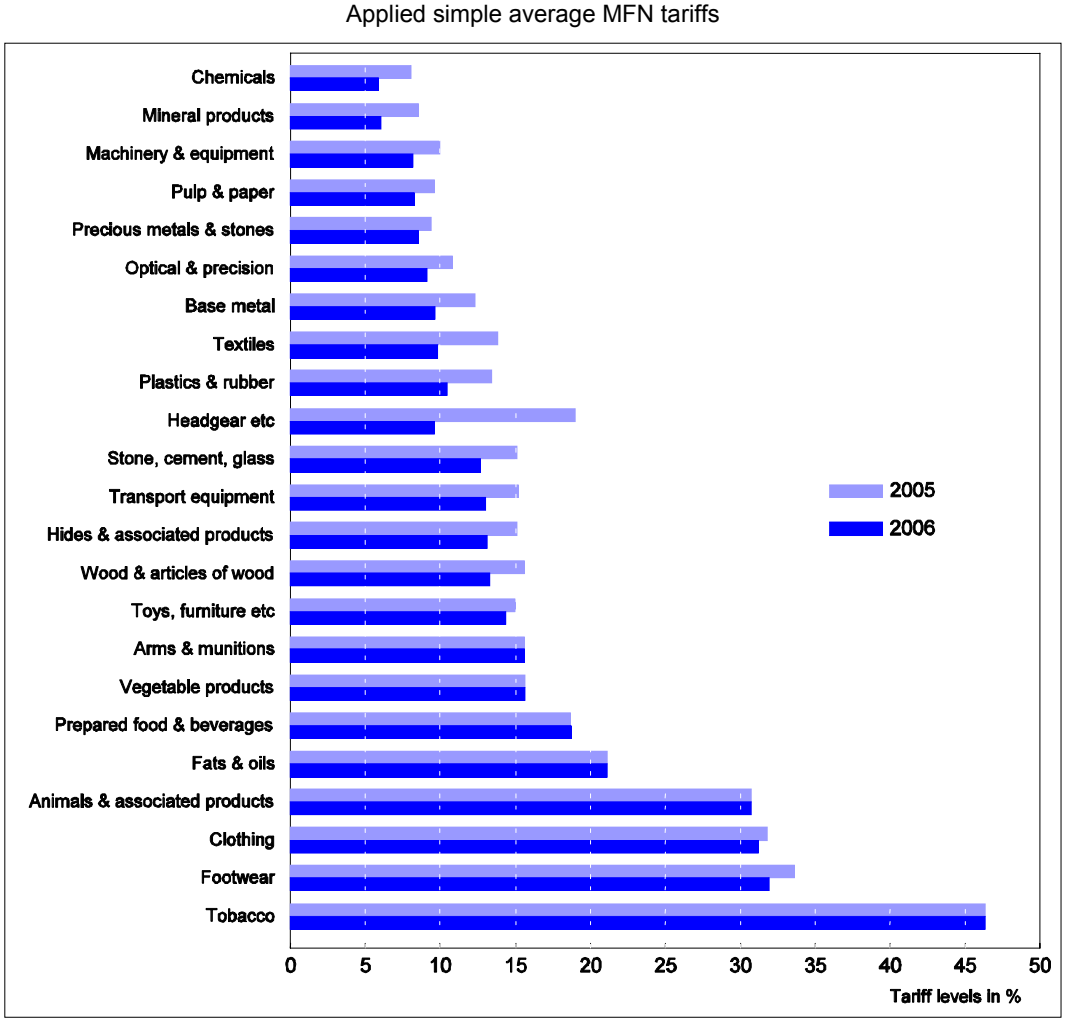
Box 4. Agriculture issues and trade[1]

Mexico currently has very high applied MFN tariffs, some over 200%. At the same time, under NAFTA, Mexico has been gradually bringing agricultural product tariffs down to zero for imports from the United States and Canada. To help farmers cope with lower border protection, the authorities have put in place direct income support programmes aimed at helping the affected sectors. The main one, PROCAMPO, is currently in place until 2012 to assist farmers in their transition to zero tariff trade in agricultural goods with Canada and the United States. One policy option to consider is to extend this gradual tariff reduction to all products with MFN agricultural tariffs. This would ensure that Mexican consumers have access to the lower cost food from anywhere in the world. As food is a greater proportion of lower income households' consumption baskets the overall impact would be progressive. Furthermore, given that in these agricultural product lines, the United States, Canada and some other RTA partners already have tariff-free access, these high MFN tariff levels may only be inducing expensive trade diversion and/or illegal triangulation schemes. Such high tariffs also increase the opportunities and incentives for fraud and corruption at the border. For example, third country coffee is imported *via* the United States to bypass the 140% MFN tariff (Ministry of Economy, 2004). If reductions in MFN tariffs were adopted, they should be implemented gradually enough to enable affected parties to adapt but not allowing policy reversal (OECD, 2005b). If MFN tariffs were reduced, further improvements to the income support programme should be made. Under PROCAMPO, direct income payments are made on historical land use. This has improved the effectiveness of the income transfer, while limiting distortions to production processes, in contrast to previous price support and subsidy measures. However, greater effort needs to be made to define the objectives of the programme. If the objective is poverty alleviation, this type of sector-specific income support may not be the best tool, as PROCAMPO does not cover landless agricultural workers. For that purpose *Opportunidades* might be more appropriate since it is more progressive. When designing the appropriate support program care should be taken to create greater incentives to increase productivity and move to more profitable crops.

1. Based on OECD (2006a), which provides a comprehensive discussion of the agricultural sector and agricultural support programmes.

32. High tariffs also persist in labour-intensive and low-productivity activities, such as clothing and footwear (Figure 11). This bias tends to lower economy-wide productivity by distorting relative prices and encouraging resources to remain in – or even flow to – low-productivity, protected sectors. Tariffs on intermediate inputs and capital equipment are lower. However, tariffs on intermediate inputs are still above those in other countries, which raises production costs in Mexico and negatively affects the cost-competitiveness of Mexican-based producers *vis-à-vis* competing foreign firms. This problem became more acute as from 2001, when to comply with NAFTA article 303, the Mexican government began phasing out import duty exemptions previously granted for materials and equipment used in producing exports destined for the United States under the *Maquiladora* and the *Programa de Importación Temporal* (PITEX) (OECD, 2007). To address this problem, Mexico uses a preferential programme, *Programas de Promoción Sectorial* (PROSECs), for raw materials and equipment not produced locally with tariffs of 0-5%. As recognised by the authorities (Ministry of Economy, 2004), this is inferior to a general tariff reduction because it imposes administrative costs (producers need to apply for PROSECs preferences) and it is only applied to some sectors. The 2006 MFN tariff cuts, which were concentrated on intermediate inputs, have helped address the problem in a more efficient way than PROSECs, but further tariff reductions are desirable.

Figure 11. Mexico's tariffs by product category[1]



1. According to the harmonised system classification.

Source: World Bank *World Integrated Trade Solution* (*WITS*) database; UNCTAD; Mexico Ministry of Economy; OECD.

Gradually reducing remaining tariffs

33. Mexico should move forward with a comprehensive and clear strategy to gradually reduce remaining tariffs. This will lead to significant net gains for Mexico as suggested by the following: *i)* the reduction of tariffs does not have large implications for government revenue (in 2005, total tariff revenue accounted for only 0.2% of GDP); *ii)* the growing share of imports from non-RTA countries means that the current MFN barriers are affecting an increasing proportion of Mexico's trade; and *iii)* reducing the approximately 60% of tariff lines with 10% or lower tariffs to a zero tariff and narrowing the wedge between MFN and RTA tariffs would reduce the cost of administration and non-tariff barriers that inhibit Mexico's trade and create opportunities for corruption and fraud. There would no longer be a need for setting reference prices on which to levy tariffs, operating special programmes such as PROSECs, monitoring rules of origin and determining which set of RTA rules apply. Gradually reducing tariffs on more highly protected products (those with 15-35% tariffs) is likely to have greater positive effects on trade flows and resource allocation and productivity, but also involves greater reallocation of labour across sectors.

Helping adjustment of workers in affected sectors

34. A standard resistance to reducing protection comes from the social hardships potentially associated with the exit of previously protected and no longer viable firms and the associated job losses. Indeed, reducing protection and creating a more open economy implies that resources have to move across sectors as the economy responds to shifting demand and relative price signals. It is important that resources, especially labour, can flow easily across sectors, in order to prevent long periods of inactivity or shifts into the low-productivity informal sector, including for the most vulnerable groups (*i.e.* the least educated and poorest workers).

35. Ensuring a smooth functioning of the labour market and appropriate training of displaced workers can help reduce these hardships. Labour market settings, in conjunction with social assistance, should ensure that the most vulnerable population groups do not bear overly high adjustment costs. This is particularly relevant for Mexico where the political support for a more open economy needs to be strengthened.

Lowering comparatively high non-tariff barriers

36. As well as moving forward with RTAs and multilateral liberalisation of MFN tariffs, the authorities are working towards progressively reducing non-tariff barriers (NTBs). Initiatives to reduce NTBs are important policy steps that will significantly improve trade flows and the cost competitiveness of Mexican firms. As tariffs declined worldwide under GATT/WTO, increasing attention has focused on the utilisation of NTBs, which have emerged as major obstacles to trade (Walkenhorst, 2004; OECD, 2005). Accordingly, methods for quantifying the effects of NTBs on prices and imports flows have been developed in the past few years, and a number of empirical studies consistently show that reductions of NTBs can lead to substantial welfare gains.[8]

37. There is evidence both at the qualitative and quantitative level suggesting that Mexican trade is currently being hampered by different types of NTBs. These include burdensome and sometimes arbitrary customs procedures, excessively strict technical requirements, including labelling rules, reference prices, as well as antidumping measures (which Mexico has used in an active way).[9] Kee *et al.* (2005) estimated *ad valorem* tariff equivalents (AVE) for a group of "core" NTBs: price and quantity control measures (*e.g.* reference prices, non-automatic licensing and quotas), technical regulations (*e.g.* labelling, testing or information requirements), as well as monopolistic measures, such as single channel for imports.[10] The estimated AVE for Mexico is the largest among the 28 OECD countries in the authors' sample, at 15.9% compared with 9% for the OECD average and below-average AVEs for the United States and Canada.

8. See Farrantino (2006) for an extensive review on the subject.

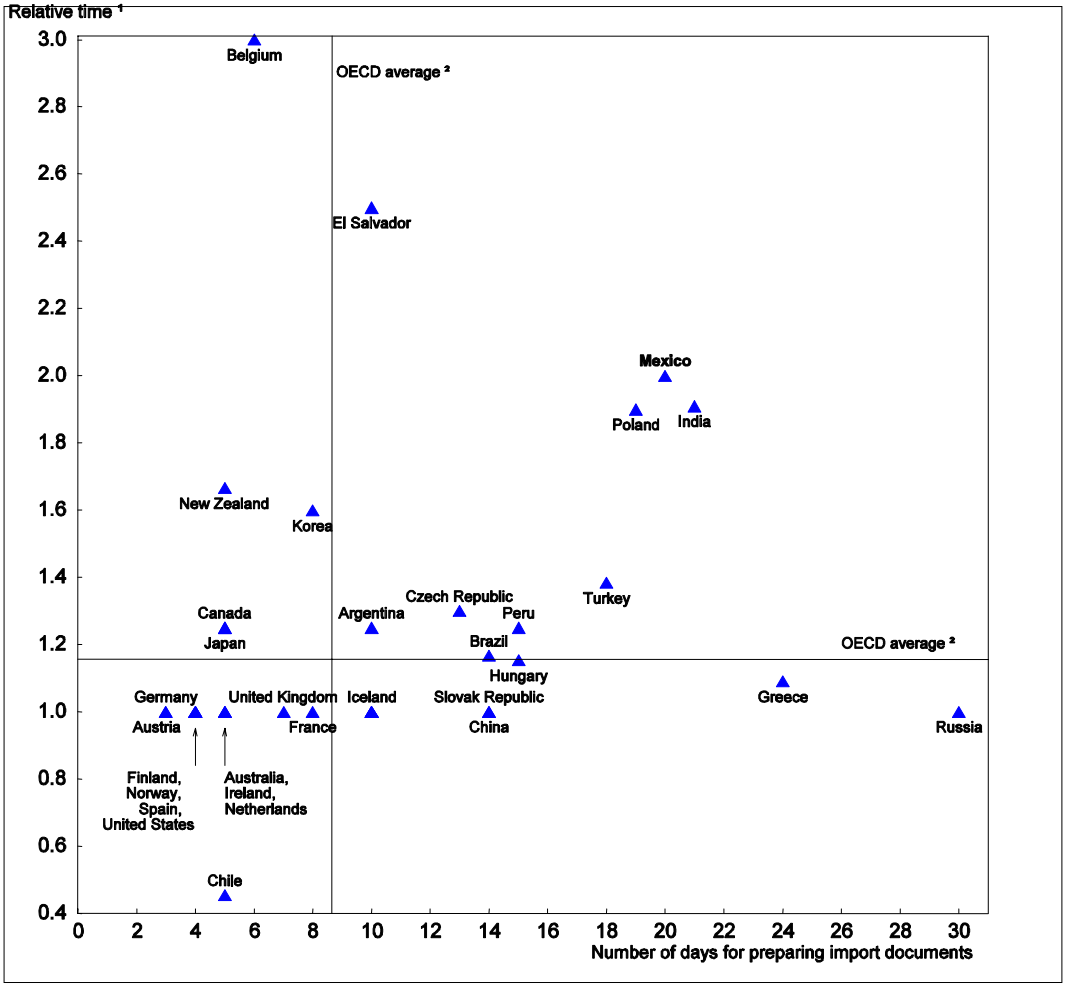
9. Mexico has more than 700 technical regulations and standards, applicable to an extensive range of products – the NOMs (*Normas Oficiales Mexicanas*) – which must be equally complied with by domestic and imported goods. The NOMs are issued by different ministries and, therefore, refer to different aspects, namely sanitary and phytosanitary requirements as well as labelling and marking requirements. There are also voluntary regulations: the NMXs (*Normas Mexicanas*).

10. These authors use the UNCTAD's *TRAINS* database, which is the most comprehensive database available and therefore the most commonly used in research. However, its country coverage is not complete and not consistently updated. Other data sources on NTBs include: compilations of business complaints provided by the European Commission (the EU *Market Access* database); the US Office of the Trade Representative (USTR); and Japan's Ministry of Economy, Industry and Trade. Business surveys also constitute complementary sources of information on NTBs – Chapter 1 in OECD (2005a) reports and compares findings from a set of 23 survey-based studies or reports.

Also, countries such as Argentina, Turkey or Poland display much smaller tariff equivalents for the considered core NTBs than Mexico.

38. A meaningful indicator for NTBs is the time required to prepare documents for importing a container (see the World Bank's *Doing Business* database). Lengthy document preparation times inhibit trade and a high ratio of time taken to prepare import documents relative to export documents is indicative of a protectionist bias in trade policy. The time needed to prepare documents for importing a container was 20 days in Mexico in 2006, as against an OECD average of 8.7 days. Among OECD countries, it is only in Greece that it takes longer (24 days). The document preparation time is shorter in other Latin American countries, such as Chile (5 days) or Brazil (14 days). Moreover, the time taken to prepare documents for importing into Mexico is very high relative to the time taken to prepare documents for exporting – the ratio is two for Mexico, which is almost twice the OECD average and much higher than in Chile and Brazil (Figure 12). This strongly suggests the need for a simplification of import procedures.

Figure 12. Time taken for import and export procedures



1. Number of days for preparing import documents over number of days for preparing export documents.
2. Excluding Luxembourg.

Source: World Bank, *Doing Business* database, various years.

Streamlining customs procedures

39. Customs procedures remain costly, overly burdensome and need to be simplified, as recognised by the authorities.[11] The requested administrative requirements are excessively complex and often redundant (for example, detailed product descriptions and information regarding the importer identification are required in several documents). Importers of sensitive products (*e.g.* agricultural products, cement, chemicals, textiles and footwear, toys, steel) must register in the specific roster (*Padrón de Importadores de Sectores Específicos*). Registration by an importer can be opposed by the domestic industry group that produces the sensitive product, which constitutes a powerful protection tool for the industry. The registration can also be time-consuming (the authorities have 30 days to confirm or reject the application, after which, in the absence of an answer, the importer is registered automatically); moreover, the specific registration co-exists with the registration in the general roster (*Padrón de Importadores*) required for all importers. If a new product is added to the list of sensitive goods, the importer must submit a new application. Progress was made recently to increase the speed of the registration procedures and address redundancies in documentary requirements. Further simplifying procedures and reducing administrative costs would not only facilitate trade, but also release public resources that could be allocated more efficiently elsewhere.

40. Both US and EU exporters (mainly from the agricultural and textile sectors, respectively) have complained about long, burdensome, arbitrary and non-transparent controls of goods during clearance.[12] Some goods (*e.g.* sugar and textiles) must enter the market through exclusive entry points – *aduanas exclusives* – which entails unnecessary transport costs, thus reducing the competitiveness of imported goods in the Mexican market. Labelling requirements are also unnecessarily cumbersome and strict and the system should be simplified by using labelling standards already applied by other OECD countries (see Annex A3). Furthermore, fines have been imposed for not correctly complying with certificate of origin or labelling requirements. In general, refusal to import is sufficient to ensure that goods without the correct certificate or that have incorrect labelling do not enter the Mexican market. Punitive sanctions such as the payment of fines should therefore be removed. Importing firms will still be motivated to comply with the certification and labelling requirements as non-compliance would mean that they are unable to complete their sale.

41. The government intends to gradually streamline import permits and compulsory registration in the *Padron Sectorial* and eventually eliminate specific ports of entry for certain goods. Mexican customs are also working to improve information systems, information exchange with other government agencies and installing non-intrusive inspection equipment (gamma ray equipment). The customs service is also setting up an anticipated maritime manifest system where ships would electronically notify customs 24 hours in advance of the goods they are carrying, which will significantly speed inspections on arrival at the wharf.

---

11. Mexican customs charge an *ad valorem* processing fee (*Derecho de Tramite Aduanero*) of 0.8% for definitive imports, from which preferential partners are in principle exempt, amounting to 0.8% *ad valorem*. Thus, there is not a unique price for the same service – the processing fee depends on the value of imported goods. Therefore, in reality such a fee works as a supplementary tariff. See Ministry of Economy (2004) .

12. See the EU *Market Access* database and USTR (2005). For instance, EU exporters note that the certificates of origin they present to customs are often rejected for minor reasons, which implies delays and the payment of high penalties – and although the Mexican authorities tried to address this problem in March 2004 by issuing guidelines for customs officials to be more flexible, the problem is still of a non-negligible dimension.

42. Mexico has a system of reference prices for customs valuation, applied mainly to foodstuffs and beverages, textiles and clothing, footwear, tools and toys. It has been in place since 1994, and serves to combat undervaluation. The authorities are considering replacing the reference price system with the transaction valuation system (which accepts the price paid by the importer in the market of origin as evidenced by invoice information) within the next two years. This would be an important step to facilitate trade as Mexico's current system is a barrier to trade.

43. In October 2000, the Mexican authorities introduced a guarantee system that is excessively burdensome. If the declared price of an imported product is lower than the reference price, importers must deposit into a Customs Account (*cuenta aduanera*) a guarantee in cash equal to the tariff duties and other taxes resulting from the difference between the declared price and the officially estimated one. According to the law, the guarantee will be cancelled only six months after the importation and only if an investigation has not been initiated.[13] The delay is too long and can create a serious liquidity constraint, which is especially problematic for small and medium-sized importers. Such a system imposes costs not only on importers, but also on the Mexican government (which has to administer it) and on the financial institutions operating the accounts. The latter have to comply with burdensome obligations, eventually passing this cost on to importers when they open a customs account and make transactions with it. It would be appropriate to eliminate the current guarantee system, which in any case becomes redundant once the reference price system is scrapped.

Increasing transparency of antidumping procedures

44. WTO members can apply antidumping (AD) measures against the imports of a product at an export price below its "normal value", usually the price of the product in the domestic market of the exporting country if such dumped imports cause injury to a domestic industry in the territory of the importing contracting party.[14] This mechanism is traditionally used in more developed economies (*e.g.* the United States, the European Union, Canada, and Australia), but it has been systematically employed by developing countries as well. Between 1985 and 1994, the number of AD investigations initiated by Argentina, Brazil, Colombia, India, Indonesia, Mexico, Peru, Turkey and Venezuela represented 16% of all investigations; in the decade that followed the establishment of the WTO (1995-2004), those nine countries were responsible for initiating 1 045 investigations, *i.e.* 40% of the total (Bown, 2006).

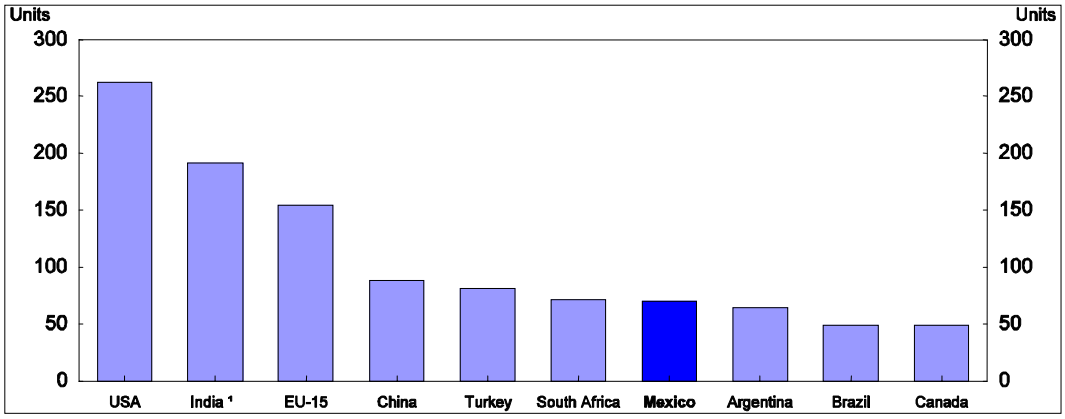
45. Between 1987 and 2005, Mexico initiated 267 AD investigations. Half of these initiations took place in 1992-94. Over the following decade, the number of initiations dropped to less than eight per year on average. In the first semester of 2006, there were 70 AD measures in force in Mexico – mainly definitive duties. The country still ranks among the top ten WTO members making recurrent use of AD (see Figure 13). Close to one-third of the AD measures in Mexico have as target China, followed by the United States (12). The steel industry has been by far the most important complainant in AD investigations in Mexico, followed by chemicals, and to smaller extent textiles.[15]

13. Ley Aduanera, art. 86-A. If an investigation begins, the guarantee will not be cancelled until the authorities reach a definite conclusion and the importer presents a certificate issued by either a customs authority or a chamber of commerce of the country of origin of the goods (certifying the declared value).

14. GATT 1994, Article 6.

15. This pattern is broadly in line with the sectoral distribution of AD actions observed in the world, where the most protected sectors are metal and metal products (about one-third of the total number of measures), see Niels and Francois (2006). AD duties are also levied on other manufactured products (coming mainly from China), such as plastic pencil sharpeners, tools and toys; and on imports from the United States, including apples, beef, and long-grain milled rice.

Figure 13. Antidumping measures in force as of 30 June 2006
Top 10 countries



1. In June 2005.

Source: WTO.

46. Although the Mexican AD system is considered to be generally in accordance with WTO rules[16] and its AD authority (*Unidad de Prácticas Comerciales Internacionales,* UPCI) is well budgeted and staffed, a number of problems should be addressed, and especially the lack of transparency and predictability of the methodology and criteria applied by the UPCI. The main problems with the AD system in Mexico concern the misclassification of information as confidential government information (thereby reducing transparency), the non-existence of published detailed guidelines for the application of the AD law (which has resulted in the application of different criteria in similar cases) and the lack of certainty in the methodology applied in the causation determination (*i.e.* the causal link between dumped imports and the injury or threat of injury alleged by domestic producers) (Leycegui and de la Torre, 2005). More transparency and less discretion are essential to enable the exporter to fairly defend its interests and to ensure cases are more easily distinguishable. It is also important to choose an appropriate substitute country for the determination of normal value if the exporting country's domestic market price is not considered to be appropriate.[17]

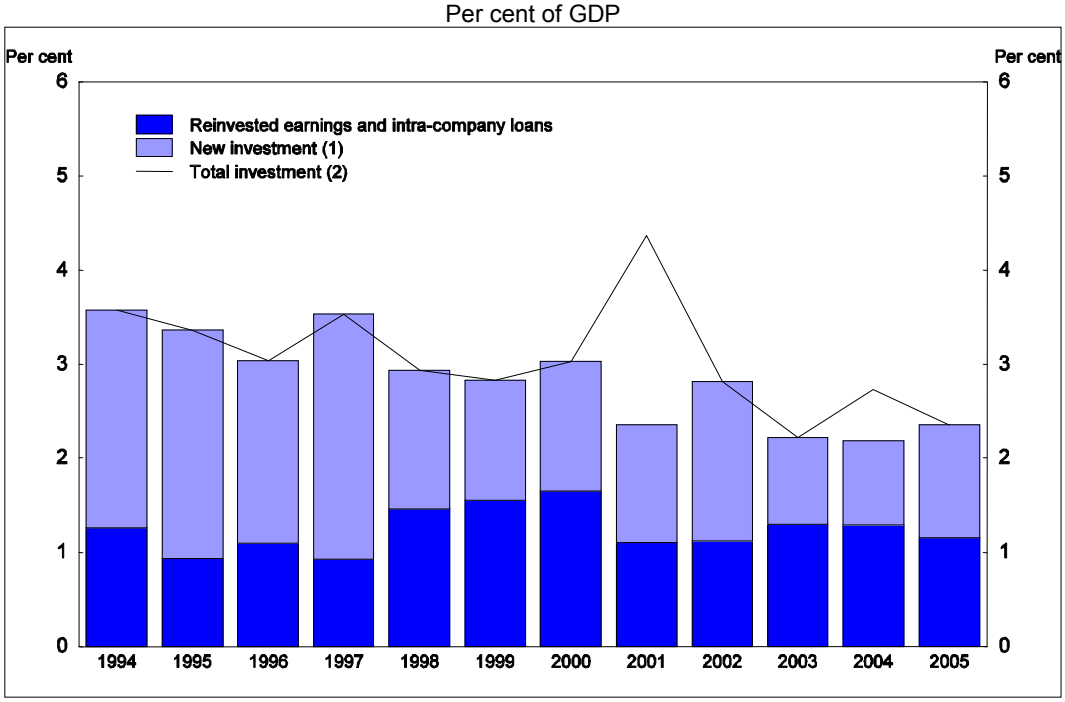
Removing obstacles to FDI and increasing linkages to the Mexican economy

47. From 1995 to 2005, Mexico has recorded large inflows of FDI, which continued even during the 1995 currency crisis. Between 1996 and 2000, gross FDI inflows averaged around 3% of GDP per year, representing a significant source of investment capital (Figure 14). Since 2000, however, inflows have slowed, stabilising at around 2% of GDP per year.

16. The need for improving the WTO Antidumping Agreement itself has been frequently emphasised because it is considered to be unclear in important aspects (*e.g.* the definition of "market economy"), and to give excessive room for discretionary application.

17. Under the WTO Antidumping Agreement two alternatives are provided for the determination of normal value if sales in the exporting country market are not on an appropriate basis. These are *i)* the price at which the product is sold to a third country; and *ii)* the "constructed value" of the product, which is calculated on the basis of the cost of production, plus selling, general and administrative expenses, and profits. It is important to choose an appropriate substitute country and not a country at a much higher level of development where cost structures are different, *e.g.* using the United States or Germany to substitute for China or choosing Mexico itself as the substitute country – this ensures that any imported good with a price below the domestic producer price will be considered dumped – as has been done by UPCI in the past (see Niels and Ten Kate, 2004).

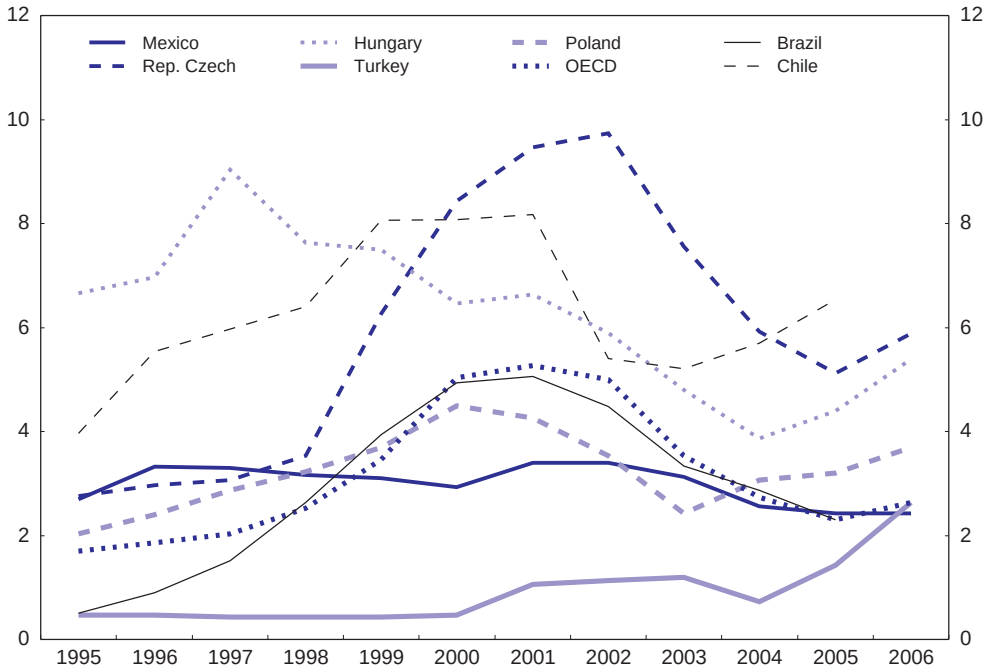
Figure 14. Gross foreign direct investment in Mexico
Per cent of GDP



1. Excludes the sale of Banamex in 2001 and the sale of BBVA-Bancomer in 2004.
2. Includes the sale of Banamex in 2001 and the sale of BBVA-Bancomer in 2004.

Source: Secretaría de Economía, Dirección General de Inversión Extranjera.

Figure 15. Gross foreign direct investment compared [1]
As per cent of GDP



1. Three-year-moving averages. Estimates for 2006 are based on the first three quarters of the year.

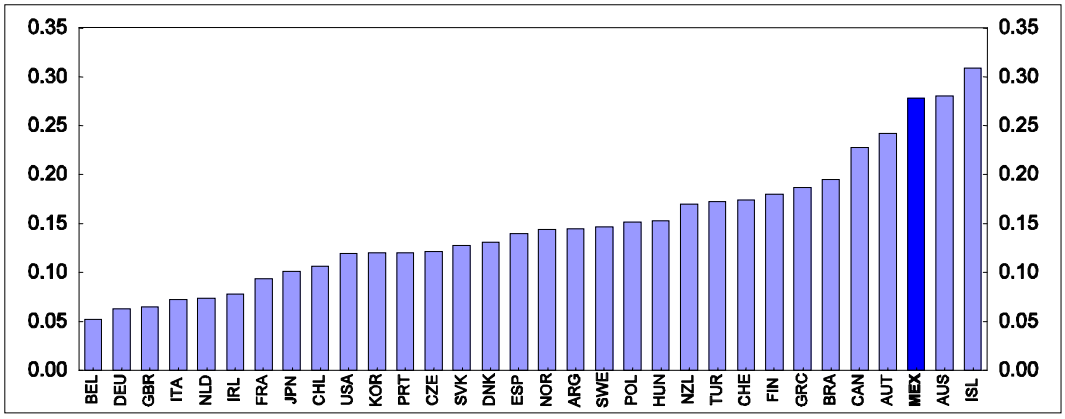
Source: World Bank and OECD.

48. In international comparison, Mexico fares relatively well, with gross FDI inflows close to the OECD average in more recent years (Figure 15). However, several catching-up OECD countries have been able to record much higher FDI inflows relative to GDP than Mexico: for instance, from 2000 to 2006, Hungary on average enjoyed a FDI/GDP ratio of 5%, the Czech Republic a ratio of 7% and Ireland a ratio approaching 11% . This suggests that if a number of bottlenecks were overcome, Mexico would be able to attract significantly higher FDI inflows than at present, given its assets – notably its geographical position, RTAs, the relatively large size of its economy and the abundance of labour.

Further reducing FDI barriers

49. Under the general Foreign Investment Law (1993) and amendments and a number of sectoral laws, Mexico still maintains a variety of barriers against FDI which are high compared with most other OECD countries, and also higher than in other Latin American countries (Argentina, Brazil and Chile) (Figure 16). More than half of the overall tightness reflects ownership restrictions, which are relatively

Figure 16. Foreign direct investment restrictiveness index[1]
2003



1. Index scale of 0-1 from least to most restrictive.

Source: Koyama and Golub (2006).

Table 3. Summary of FDI ownership restrictions[1]

Restriction	Sector/Activity
Activities reserved to the state	Petroleum and hydrocarbons, electricity
Activities reserved to Mexican nationals	Domestic land transportation, gasoline retail sales and distribution of LPG
Ownership limits	Up to 25% in airlines. Up to 49% in telecommunications, insurance companies, retirement funds management and coastal shipping
Ownership above 49% with government approval	Cellular telecommunications, airports, railways, ports, legal services, insurance agents, construction of pipelines for distribution of petroleum products, drilling of petroleum and gas wells

1. The complete list of sectors covered by these barriers is listed in Annex 3.A4.

Source: Ministry of Economy.

strict. Screening and notification procedures are also relatively complex, while management (e.g. a minimum proportion of positions reserved for nationals) and operational restrictions (e.g. domestic content requirements), although not insignificant, are not out of line with many other OECD countries. The four main levels of ownership barriers and the sectors of particular importance for trade and productivity performance are summarised in Table 3 below.

50. Barriers to FDI are higher than the OECD average across all the main sectors of the economy (Table 4). They are concentrated in services and infrastructure sectors: finance, business services, energy, transport infrastructure, including land transport, ports and airports and telecommunications. Because they provide inputs for the whole economy, these sectors are important for Mexico's overall economic performance as well as for its external trade performance.

Table 4. OECD FDI regulatory restrictiveness index for Mexico by sector[1]

	Mexico	OECD Average	Rank out of 29 countries (best to worst)
Business services	0.206	0.152	21
Telecoms	0.356	0.184	24
Construction	0.125	0.074	24
Distribution	0.125	0.072	24
Finance	0.502	0.152	24
Hotels and restaurants	0.125	0.072	24
Transport	0.428	0.299	26
Electricity	1	0.326	29
Manufacturing	0.125	0.076	24
TOTAL	0.278	0.187	28

1. Index scale of 0-1 from least to most restrictive. See Annex 3.A4 for more details.

Source: Koyama and Golub (2006).

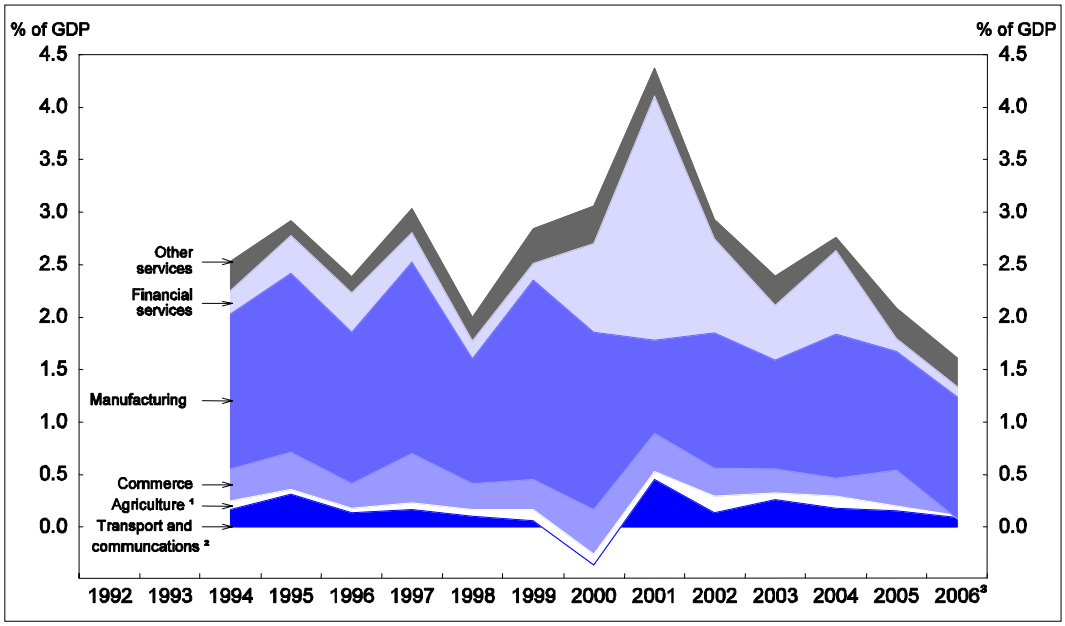
51. The FDI stock is still relatively low as a share of GDP compared with many other OECD countries; and OECD estimates suggest that reducing FDI restrictions to those prevailing in the least restrictive country in the OECD would increase the stock of FDI in Mexico by 50% (Nicoletti *et al*., 2003).[18] Where barriers are lower (such as in manufacturing) or have been reduced (such as in financial services), there have been significant inflows of FDI capital. From 1994 to 2005, manufacturing accounted for approximately half of gross FDI inflows, reflecting Mexico's comparative advantage and proximity to the United States. FDI in manufacturing has not been supported by large inflows of FDI in complementary service and infrastructure sectors (see Figure 17). The main exception is financial services where restrictions on foreign equity ownership of banks have been lifted (see below).[19] As a result Mexico has efficient manufacturing plants in sectors such as automobiles, but these investments are negatively affected by the lack of adequate services and infrastructure as well as imported inputs at competitive prices.

18. This is based on simulating an equation explaining foreign investment flows, which includes a wide range of explanatory variables, including whether there is a free trade agreement and also the level of FDI restrictiveness, which is itself a function of screening requirements, ownership restrictions and operational restrictions. The equation was estimated for a panel of 21 OECD countries from 1980 to 2000.

19. Remaining statutory limitations in the banking sector concern foreign presence in the form of a branch and the possibility for the authorities to take remedial action if the share of foreign investors in the aggregate total net capital of all commercial banks reaches 25% (see Annex 3.A4).

52. Mexico's experience in removing foreign investment restrictions on its largest banks in 1998 is illustrative of the potential effects of lifting unduly restrictive regulations on FDI. The removal of barriers led to a rapid increase in foreign ownership of Mexican banks: the percentage of total commercial banking assets owned by foreign firms rose from 7% in 1995 to 25% in 1998 and 85% by 2006, including major investments by the United States' Citibank and Spain's BBVA and Santander.

Figure 17. Gross FDI inflows by sector



1. Agriculture, mining, electricity and construction.
2. FDI inflows can be negative if a domestic enterprise owned by a foreign investor is sold by the investor to another domestic enterprise, makes a loss, pays back previous borrowings to it overseas parent, is loaning money to its overseas parent or returns capital back to its parent.
3. Estimates for 2006: actual data for two quarters at an annual rate.

Source: World Bank and OECD.

53. Reducing barriers to FDI and increasing the scale of inflows back to earlier levels would be beneficial for Mexico's future growth performance. FDI is closely related to goods trade and, in non-manufacturing, commercial presence is one of the main modes of cross-border service supply. Higher FDI increases competitive pressures in the economy. Furthermore, FDI is also an important vehicle for technology transfer and a stimulus to innovative activity (Nicoletti *et al*., 2003). Through all these channels (competition, trade, technology transfers), FDI is considered to be an increasingly important driver of growth (OECD, 2002, 2002a). There is also abundant empirical evidence that FDI boosts labour productivity, both directly by augmenting the capital stock and indirectly by inducing greater domestic capital investment (Ramirez, 2006). Encouraging flows of foreign capital to the services and infrastructure sectors would enhance the quality and cost competitiveness of the inputs used by the manufacturing sector, thereby assisting trade performance. In some of these sectors (insurance and transport), it would also open up the possibility for increasing Mexican services exports.

Increasing benefits from FDI by strengthening spillovers to domestic firms

54. Important benefits from higher FDI are the supply chain linkages from the FDI investor to domestic firms and the knowledge and technology transfers that often accompany direct investment. Investors transfer know-how to their subsidiaries, and in many cases also their direct business partners,

which have the potential to spill over into the host economy more generally. Vertical transfers to domestic suppliers of manufactured inputs have been demonstrated by empirical evidence (see Kugler, 2006, Javorcik, 2006). Nevertheless, linkages and spillovers are far from automatic and depend on framework conditions and the absorptive capacity of domestic firms. In the automobiles sector and other industries in Mexico, there is potential for greater linkages between FDI investors and Mexican firms. These would boost Mexico's returns from FDI.

55. Foreign direct investors are keen to widely outsource locally as local production represent a potential source of cost savings and security of supply. Empirical evidence shows that even where multinational companies initially import most of their supplies these imports tend to be eventually replaced by domestically sourced goods (OECD, 2002). Even if the multinational has suppliers outside Mexico it may also want to source locally as this provides competition for international suppliers.

56. However, developing vertical linkages requires strengthening incentives for investors to outsource locally and this implies improving the ability of local firms to supply inputs that meet the multinationals' requirements. Paus and Gallagher (2006) find that, in the electronics industry in particular, foreign firms have either invited other multinational suppliers of manufactured components to locate in Mexico with them or sourced from sub-contracting firms already established in Asia. In this industry, Mexican firms are mainly involved in providing packaging materials. This highlights that the business environment needs to be further improved so that it encourages more domestic firms to improve their product quality and cost competitiveness, which would allow them to strengthen their linkages to foreign-owned firms and supply a wider range of inputs.

Encouraging linkages with domestic firms

57. The Mexican manufacturing sector consists of a large number of small firms, with a few very large firms and a very small proportion of medium-sized firms. This structure itself contributes to limit supply chain linkages that would help smaller firms to grow and increase their productivity.[20] Mexican firms have sometimes been unable to supply multinationals in the electronics and automobile sectors, two of the largest export industries in Mexico, because of a lack of scale and technical capabilities and quality.

58. Links between foreign investors and their direct domestic suppliers (tier-1 suppliers), which are often large companies, are reasonably strong. However, there are only weak links between the tier-1 suppliers and their, generally smaller, suppliers (tier 2 and tier 3 suppliers). The government assists small firms in developing linkages with large firms, in particular through the Supplier Development Programme (SDP) supported by the Ministry of Economy, the National Association of Manufacturers and the United Nations Development Program. The programme has helped the formation of voluntary strategic alliances and permanent commitments between large foreign firms and SME suppliers and there appears to be some evidence of increased efficiency and profitability of firms inside the programme.[21] Consistent with the government's intention to evaluate the impact of public spending, there should be a cost-benefit evaluation of the programme before further increasing its budget. Public support to FDI inflows can be useful, but it is important to provide the most cost-effective solution, especially given Mexico's fiscal constraints.

---

20. Illustrating the importance of linkages, a key source of innovations for Mexican suppliers to Wal-Mart Mexico (Walmex) has been their own input suppliers, usually foreign affliates (Javorcik, Keller, Tybout, 2006), which Mexican firms meet regularly.

21. The SDP is currently small relative to the size of Mexico's large export industries where there is potential for greater linkages. In auto manufacturing, 40 auto parts firms are involved out of a total of 1 000 auto parts firms in Mexico. The programme's budget was doubled between 2005 and 2006 to US$10 million (OECD, 2006b).

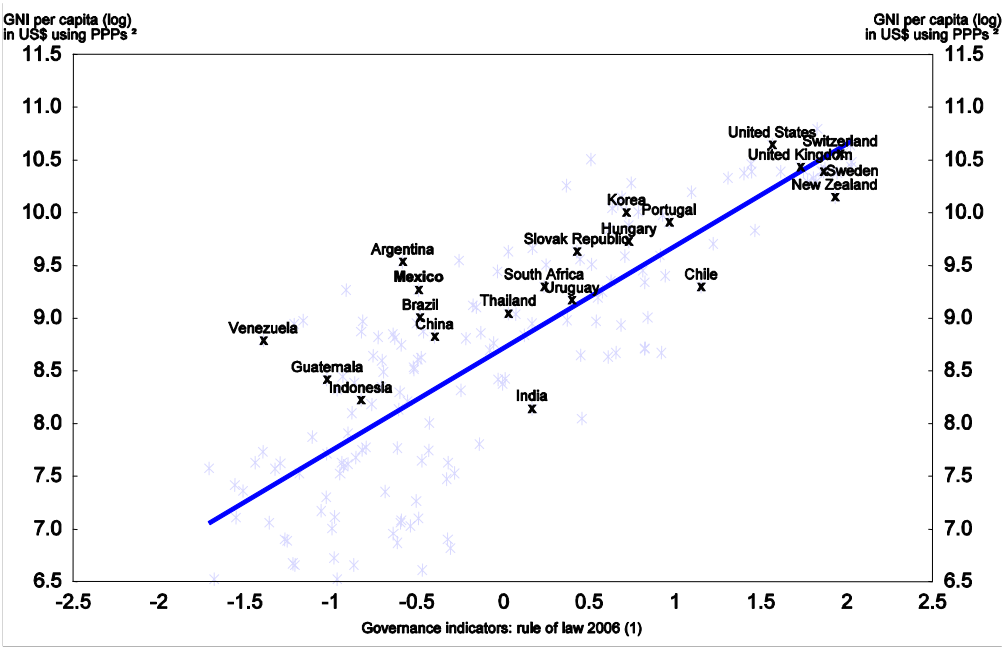
59. FDI promotion efforts aimed at strengthening the linkages with domestic firms are more effective when complemented with flanking policies that improve the investment climate (OECD, 2006c). For instance, increasing human capital and product market competition will boost incentives to invest and raise the absorptive capacity of local firms, thereby enabling closer linkages with foreign investors and domestic firms. Strengthening the rule of law, which is a priority of the government, will also help to encourage FDI by giving investors greater certainty over returns and lowering transactions costs (Box 5). The authorities are considering developing an investment facilitation action plan at all levels of government. Following a comprehensive approach to create an attractive investment climate would help to mobilise investment by both foreign and domestic firms. The *Policy Framework for Investment* developed by the OECD can be usefully applied to facilitate such a process.

Box 5. The rule of law in Mexico

The rule of law can be defined as the extent to which agents have confidence in, and abide by, the official rules of society. These include perceptions of the incidence of both violent and non-violent crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts (Kaufmann *et. al*, 1999). A strong rule of law, where fair, transparent and predictable rules form the basis of economic and social interactions, is fundamental to efficiency and growth in a market economy. This is because it encourages individuals and firms to make human and physical capital investments and engage in profitable transactions by giving them greater certainty over returns. It also helps to minimise transactions costs. Empirical work suggests that the effect of the rule of law on growth in per capita income is positive and quantitatively important and that the channels from better rule of law to growth include greater exports and FDI.[1]

According to the World Bank's rule of law indicator, Mexico is below average among 207 countries, with no improvement between 1998 and 2005 (Figure 18). Improving the rule of law would have large potential gains for Mexico, including through greater trade and FDI flows. In this context, the government's priority on improving security

Figure 18. Rule of law indicator[1]



1. The rule of law represents the extent to which agents have confidence in and abide by the rules of society. This indicator includes perceptions of the incidence of the effectiveness and predictability of the judiciary, the enforceability of contracts and both violent and non-violent crimes (World Bank). This indicator is scaled from about -2.5 to 2.5, from worst to best.
2. 2005 or latest year available.

Source: World Bank, *2006 Governance Indicators* and GDP database.

and the rule of law in Mexico is an important part of its development strategy. It should continue to include measures to improve public security and reduce crime, particularly by reducing corruption and raising capability in law enforcement. Increasing the enforceability of contracts is also important. Some steps have already been taken in recent years to improve the enforceability of credit contracts by reforming the legal framework for the recovery of collateral (OECD, 2005f).

Streamlining the process for *amparo* hearings should also be tackled. *Amparo* lawsuits often delay or undermine actions and decisions by regulatory bodies. *Amparo* proceedings are established by the constitution, to grant all persons protection against unconstitutional acts by government. Of particular relevance for economic regulation is article 16 of the constitution that stipulates that agency orders articulate the "legal basis and justification for the action taken". An *amparo* action in a federal district court may be brought by any party based on wide-ranging grounds (for example, that a law is unconstitutional or, on the basis of article 16, that an agency action is arbitrary, unsupported by substantial evidence or founded on reasoning that is illogical or contrary to general principles of law). *Amparos* are a necessary instrument provided by the constitution to check the arbitrary use of government power, and competition law and other economic regulation, like all legislation in Mexico, must accommodate this. However, competition and other legislation must be as clear and unambiguous as possible to limit the abuse of *amparo* proceedings because such abuse is occurring frequently and in effect blocks competition law enforcement and the effectiveness of regulations.

---

1. On the links between institutions, including the rule of law, and growth, see Knack and Keefer (1997), Hall and Jones (1999), Kaufmann *et al.* (1999), Acemoglu *et al.* (2001) and Rigobon and Rodrick (2004). Oliva and Rivera-Batiz (2002) and Méon and Sekkat (2004) examine links between trade, FDI and the rule of law.

Concluding remarks

60. Mexico has made substantial progress in liberalising trade and foreign investment and this has helped to boost growth. Nevertheless, there is room to go further and bring tariffs down to levels prevailing in the OECD and even non-OECD middle-income countries. MFN tariffs are becoming more constraining as the share of Mexico's imports coming from non-RTA countries is growing. Furthermore, the current combination of 12 RTAs, with different terms, and a large difference between RTA and MFN tariffs creates opportunities for fraud and corruption and is expensive to administer, while raising little fiscal revenue. There is also scope to reduce NTBs. In addition, ownership restrictions on foreign investment in services and infrastructure sectors should be eased so as to attract higher capital inflows and improve productivity. In this context, it is particularly important to continue improving the overall investment climate. Detailed recommendations to promote trade integration and FDI flows are contained in Box 6.

Box 6. Main recommendations on trade and FDI

Gradually reduce MFN tariffs

- Implement a comprehensive programme to gradually reduce remaining applied tariffs.
- Develop effective labour market programmes to support affected workers, in particular in sectors where protection is higher and resource allocation effects will be greater.

Reduce non-tariff barriers

- Simplify and increase the transparency of customs procedures, antidumping procedures and technical standards (*e.g.* labelling). Where possible, automate these procedures using more information technology systems and reduce the processing fees.
- Eliminate punitive sanctions for failing to meet labelling standards and incorrect certificates of origin including fines and confiscation of goods.
- Remove special registration lists for imported goods and merge with the general list already in place.

- Eliminate the reference price and guarantee system and replace with the transaction valuation method *i.e.* importer valuation with accompanying documentary evidence.
- Eliminate exclusive entry locations in Mexico for some products and eliminate remaining import permits (non-automatic import licensing, *e.g.* for cars and used machinery).

Further facilitate FDI and maximise the benefits from FDI

- Eliminate ownership restrictions on foreign investment in services and infrastructure sectors such as telecommunications, domestic land transport, coastal shipping and airports.
- Continue efforts to facilitate linkages between FDI investors and smaller domestic firms, evaluating existing programmes for their cost-effectiveness and ensuring that support is available across the board, without attempting to pick winners.
- Strengthen the rule of law, to improve the business environment.
- Implement an investment facilitation action plan at all levels of government; the *Policy Framework for Investment* developed by the OECD could provide useful support.

BIBLIOGRAPHY

Acemoglu, D., S. Johnson and J.A. Robinson (2001), "The Colonial Origins of Comparative Development: An Empirical Investigation", *The American Economic Review*, 91, 1369-1401.

Ahn, S. and P. Hemmings (2000), "Policy Influences on Economic Growth in OECD Countries: An Evaluation of the Evidence", *OECD Economics Department Working Papers*, No. 246.

Bown, C. (2006), "The WTO and Antidumping in Developing Countries", July, *http://ssrn.com/abstract=920850.*

Cabral, S. and P. Soares Esteves (2006), "Portuguese Export market shares: An Analysis of Selected Geographical and Product markets", *Bank of Portugal Economic Bulletin*, Summer.

Chang R., L. Kaltani, and N. Loayza (2005), "Openness Can be Good for Growth: the Role of Policy Complementarities", *NBER Working Papers*, No. 11787.

de la Torre, L. E. R. and J. G. González (2005),"Antidumping and Safeguard Measures in the Political Economy of Liberalization: The Mexican Case", *World Bank Policy Research Working Papers*, No. 3684.

Dennis, A. (2006), "Trade Liberalization, Factor Market Flexibility, and Growth: the Case of Morocco and Tunisia", *Word Bank Policy Research Papers*, No. 3857.

Duval, R. and J. Elmeskov (2005), "The Effects of EMU on Structural Reform in Labour and Product Markets", *OECD Economics Department Working Papers*, No. 438.

Ferrantino, M. (2006), "Quantifying the Trade and Economic Effects of Non-tariff Measures", *OECD Trade Policy Working Papers*, No. 28.

Hall, R.E. and C.I. Jones (1999), "Why Do Some Countries Produce So Much More Output Per Worker Than Others?", *The Quarterly Journal of Economics*, Vol. 114, 83-116.

Helpman, E.T. and D. Coe (1995), "International R&D Spillovers", *European Economic Review*, Vol. 39, 859-87.

IADB (2005), *Emergence of China: Opportunities and Challenges for Latin America and the Carribean*.

Javorcik, B., W. Keller and J. Tybout (2006), "Openness and Industrial Response in a Wal-Mart World: A Case Study of Mexican Soaps, Detergents and Surfactant Producers", *World Bank Policy Research Working Papers*, No. 3999.

Kaufmann, D., A. Kraay and P. Zoido-Lobatón (1999), "Governance Matters", *World Bank Policy Research Working Papers*, No. 2196.

Kee, H. L., A. Nicita and M. Olarreaga (2005), "*Ad Valorem* Equivalents of Non-Tariff Barriers", World Bank, Washington, D.C.

Knack, S. and P. Keefer (1997), "Why Don't Poor Countries Catch Up? A Cross-National Test of an Institutional Explanation", *Economic Inquiry*, Vol. 35, 590-602.

Koyama, T. and S. Golub (2006), "OECD's FDI Regulatory Restrictiveness Index: Revision and Extension for More Economies", *OECD Economic Department Working Papers,* No. 525.

Kugler, M. (2006), "Spillovers from Foreign Direct Investment, Within or Between Industries", *Journal of Development Economics,* Vol. 80, 444-77.

Leycegui, B. and L. E. R. de la Torre (2005), "The 10 Major Problems with the Antidumping Instrument in Mexico", *Journal of World Trade*, Vol. 39, No. 1.

Lipsey, R.G. and K. Lancaster (1956), "The General Theory of Second Best", *The Review of Economic Studies*, Vol. 24, No. 1.

Ministry of Economy (2004), *Acciones Concretas para Incrementar la Competitividad*, Mexico, D.F.

Méon, P. and K. Sekkat (2004), "Does the Quality of Institutions Limit the MENA's Integration in the World Economy?", *World Economy*, Vol. 27, 1475-98.

Niels, G. and J. Francois (2006), "Business Cycles, the Exchange Rate, and Demand for Antidumping Protection in Mexico", *Review of Development Economics*, Vol. 10, No. 3.

Niels, G. and A. ten Kate (2004), "Anti-dumping Protection in a Liberalising Country: Mexico's Anti-dumping Policy and Practice", *The World Economy*, Vol. 27, No. 7.

Nicoletti, G., S. Golub, D. Hajkova, D. Mirza and K.Y. Yoo (2003), "Policies and International Integration: Influences on Trade and Foreign Direct Investment", *OECD Economics Department Working Papers*, No. 359.

Nicoletti, G. and S. Scarpetta (2005), "Product Market Reforms and Employment in the OECD Countries", *OECD Economics Department Working Papers*, No. 472.

OECD (2002), *Foreign Direct Investment and Development: Where Do We Stand?*, Paris, OECD.

OECD (2002a), *Foreign Direct Investment for Development – Maximising Benefits, Minimising Costs*, Paris, OECD.

OECD (2003), *The Sources of Economic Growth*, Paris, OECD.

OECD (2005), "The Benefits of Liberalising Product Markets and Reducing Barriers to International Trade and Investment in the OECD", *Economics Department Working Papers,* No. 463.

OECD (2005a), *Looking Beyond Tariffs: the Role of Non-tariff Barriers in World Trade*, Paris, OECD.

OECD (2005b), *Trade and Structural Adjustment*, Paris, OECD.

OECD (2005c), *Going for Growth*, Paris, OECD.

OECD (2005d), *OECD Economic Globalisation Indicators*, Paris, OECD.

OECD (2005e), *OECD Economic Survey of Mexico*, Paris, OECD.

OECD (2006), *Going for Growth*, Paris, OECD.

OECD (2006a), *Agricultural and Fisheries Policies in Mexico*, Paris, OECD.

OECD (2006b), *Review of SME Issues and Policies in Mexico*, Paris, OECD.

OECD (2006c), *Policy Framework for Investment: A Review of Good Practices*, Paris, OECD.

OECD (2006d), *Policy Framework for Investment*, Paris, OECD.

OECD (2007), "Export Processing Zones: Past and Future Role in Trade and Development", *OECD Trade Policy Working Papers*, No. 53.

Oliva, M. and L.A. Rivera-Batiz (2002), "Political Institutions, Capital Flows, and Developing Country Growth: An Empirical Investigation", *Review of Development Economics*, Vol. 6, 248-62.

Oliveira Martins, J. and T. Price (2000), "Policy Interdependence during Economic Transition: the Case of Slovakia 1999-2000", *OECD Economics Department Working Papers,* No. 253.

Pages, C., G. Pierre and S. Scarpetta (2007), *Job Creation in Latin America and the Caribbean, Recent Trends and the Policy Challenges*, World Bank, Washington, D.C.

Paus, E.A. and K.P. Gallagher (2006), "The Missing Links Between Foreign Investment and Development: Lessons from Costa Rica and Mexico", *Growth, Development and Environment Institute Working Papers*, No. 06-01.

Ramirez, M.D. (2006), "Is Foreign Direct Investment Beneficial for Mexico? An Emprical Analysis, 1960-2001", *World Development*, Vol. 34, 802-17.

Rigobon, R. and D. Rodrik (2004), "Rule of Law, Democracy, Openness and Income: Estimating the Interrelationships", *NBER Working Papers*, No. 10750.

USTR (2005), *National Trade Estimate Report on Foreign Trade Barriers*.

Walkenhorst, P. (2004), "EU Exporter Concerns about Non-tariff Measures", *Applied Economic Letters*, Vol. 11, No. 15.

Winters, A. (2004), "Trade Liberalisation and Economic Performance: An Overview", *The Economic Journal*, Vol. 114, No. 493.

WTO (2002), *Trade Policy Review Mexico*, Report by the Secretariat.

ANNEX A1
CONSTANT MARKET SHARE METHOD

The method used in the paper follows that used by Cabral and Soares-Esteves (2006). Mexico's total market share at time t ,Q_t, *c*an be expressed as:

$$Q_t = \frac{\sum_i \sum_j X_{ijt}}{\sum_i \sum_j M_{ijt}} = \sum_i \sum_j X_{ijt} \frac{1}{\sum_i \sum_j M_{ijt}} = \sum_i \sum_j Q_{ijt} \frac{M_{ij}}{\sum_i \sum_j M_{ijt}}$$

Where X_{ijt} are the Mexican exports of product *i* to country *j* at time *t, M_{ijt}* are the Mexican exports of product *i* to country *j* at time *t* and the ratio of the two variables Q_{ijt} is the Mexican market share of product *i* in country *j* at time *t*.

The percentage change of the total export market share can be expressed as:

$$\frac{\Delta Q}{Q_{t-1}} = \frac{Q_t - Q_{t-1}}{Q_{t-1}} = \sum_i \sum_j \frac{Q_{ijt} - Q_{ijt-1}}{Q_{ijt-1}} \frac{X_{ijt-1}}{\sum_i \sum_j X_{ijt-1}} + \sum_i \sum_j \Delta\left(\frac{M_{ijt}}{\sum_i \sum_j M_{ijt}}\right) \frac{Q_{ijt-1}}{Q_{t-1}} + \sum_i \sum_j \frac{Q_{ijt} - Q_{ijt-1}}{Q_{ijt-1}} \Delta\left(\frac{M_{ijt}}{\sum_i \sum_j M_{ijt}}\right)$$

where $\Delta\left(\frac{M_{ijt}}{\sum_i \sum_j M_{ijt}}\right) = \frac{M_{ijt}}{\sum_i \sum_j M_{ijt}} - \frac{M_{ijt-1}}{\sum_i \sum_j M_{ijt-1}}$ $\qquad \Delta\left(\frac{M_{ijt}}{\sum_i \sum_j M_{ijt}}\right) = \frac{M_{ijt}}{\sum_i \sum_j M_{ijt}} - \frac{M_{ij}}{\sum_i \sum_j}$

The growth rate of the overall market share can be divided into three terms:

(i) The market share effect: this component is the sum of the change in market share in each market (product i to destination j) weighted by the share of that market in total Mexican exports. It measures how well Mexican exports are performing in each of their individual markets. Factors such as cost-competitiveness, product quality and trends in tastes and preferences will influence this performance.

(ii)The combined structure effect: this is the part of the total change in market share that results from the product and geographical specialisation of the country. Geography and product effects will be positive (negative) if Mexico is relatively specialised in fast (slow) growing markets relative to the world average.

This combined structural effect can be further broken down to identify separately the effects of geographical and product specialisation:

(iia) Geographical structure effect: the part of the total change in the market share resulting from the geographical specialisation of Mexican exports:

$$\sum_j \Delta \frac{M_{jt}}{\sum_j M_{jt}} \frac{Q_{jt-1}}{Q_{t-1}} \text{ where } M_{jt} = \sum_i M_{ijt} \text{ and } Q_{jt-1} = \frac{\sum_i X_{ijt-1}}{M_{jt-1}}$$

(iib) Product structure effect: the part of the total change in the market share resulting from the product specialisation of Mexican exports:

$$\sum_i \Delta \frac{M_{it}}{\sum_i M_{it}} \frac{Q_{it-1}}{Q_{t-1}} \text{ where } M_{it} = \sum_j M_{ijt} \text{ and } Q_{it-1} = \frac{\sum_j X_{ijt-1}}{M_{it-1}}$$

(iic) Structural effect decomposition residual: this term arises because the sectoral and geographical structures are not independent so the sum of the geographical and product effects is not equal to the combined structure effect.

(iii) Residual: the difference between the market share and combined structure effects and the change in the total market share.

ANNEX A2
STRUCTURE OF MEXICAN MANUFACTURED EXPORTS TRADE AND CONSTANT MARKET SHARE RESULTS

Table A1.1 Share of selected categories by partner in total Mexican manufactured exports

Stored by the average total of the category

	Average 1994-2000					Average 2001-2006			
	HS (1988) category	USA	Rest of the world	Total		HS (1988) category	USA	Rest of the world	Total
Motor vehicles for transport of persons (except buses)	8 703	9.4	1.7	11.1	Motor vehicles for transport of persons (except buses)	8 703	7.7	1.4	9.1
Circuits and components	85_s4	8.3	0.3	8.6	Radio, recording equipment	85_s2	8.0	0.4	8.3
Radio, recording equipment	85_s2	8.2	0.2	8.4	Computers and office machines	84_s3	7.2	1.0	8.1
Clothing and footwear	60_67	6.7	0.1	6.8	Circuits and components	85_s4	6.6	0.3	6.9
Computers and office machines	84_s3	5.5	1.0	6.5	Electric motors and appliances	85_s1	5.6	0.2	5.8
Electric motors and appliances	85_s1	5.7	0.2	6.0	Television equipment	85_s3	5.5	0.2	5.7
Base metals	72_83	5.1	0.9	5.9	Clothing and footwear	60_67	5.4	0.1	5.5
Chemicals, rubber and plastics	28_40	4.3	1.3	5.6	Base metals	72_83	4.9	0.6	5.5
Wire and cables	85_s5	5.3	0.0	5.4	Parts and accessories for motor vehicles	8 708	5.1	0.3	5.3
Television equipment	85_s3	4.5	0.0	4.6	Chemicals, rubber and plastics	28_40	4.1	1.2	5.3
Parts and accessories for motor vehicles	8708	3.8	0.2	3.9	Motor vehicles for the transport of goods	8704	4.4	0.1	4.5
Engines	84_s1	3.1	0.7	3.8	Wire and cables	85_s5	4.3	0.1	4.3
Toys, furniture and miscellaneous	93_96	3.5	0.2	3.7	Optical and precision equipment	90_92	4.0	0.3	4.3
Motor vehicles for the transport of goods	8 704	3.5	0.0	3.5	Toys, furniture and miscellaneous	93_96	4.0	0.2	4.2
Optical and precision equipment	90_92	3.0	0.2	3.1	Engines	84_s1	2.8	0.5	3.3
Other 84	84_s4	2.4	0.2	2.6	Pumps, fridges, heaters and filters	84_s2	2.9	0.1	3.0
Articles of stone, cement, glass and jewellery	68_71	2.0	0.3	2.3	Other 84	84_s4	2.6	0.2	2.8
Prepared food	16_24	1.7	0.3	2.1	Prepared food	16_24	2.2	0.3	2.5
Pumps, fridges, heaters and filters	84_s2	1.9	0.1	2.0	Articles of stone, cement, glass and jewellery	68_71	2.2	0.2	2.4
Textiles	50_59	1.0	0.3	1.4	Textiles	50_59	0.7	0.2	0.8
Other 87	87oth	1.0	0.0	1.0	Pulp and paper products	47_49	0.8	0.0	0.8
Pulp and paper products	47_49	0.9	0.0	1.0	Other 87	87oth	0.8	0.0	0.8
Aircraft and ships	88_89	0.4	0.0	0.4	Railway equipment	86	0.3	0.0	0.3
Railway equipment	86	0.3	0.0	0.3	Aircraft and ships	88_89	0.2	0.0	0.3
		91.7	8.3	100.0			92.3	7.7	100.0

Source: OECD Calculations, OECD International Trade by Commodity Statistics.

Table A1.2 Contributions to the total change of Mexican market share

	HS (1988) category	1994-2000			2001-2006		
		USA	Rest of the world	Total	USA	Rest of the world	Total
Prepared food	16_24	1.4	0.2	1.6	0.4	0.0	0.5
Chemicals, rubber and plastics	28_40	2.5	0.0	2.5	-0.6	0.3	-0.3
Pulp and paper products	47_49	0.5	0.0	0.5	-0.2	0.0	-0.1
Textiles	50_59	0.8	0.0	0.8	-0.5	-0.1	-0.7
Clothing and footwear	60_67	8.6	0.1	8.7	-3.7	-0.1	-3.7
Articles of stone, cement, glass and jewellery	68_71	1.1	0.1	1.2	0.5	-0.1	0.5
Base metals	72_83	2.8	-0.2	2.6	-0.2	0.6	0.4
Engines	84_s1	1.0	-0.5	0.5	-0.4	-0.1	-0.4
Pumps, fridges, heaters and filters	84_s2	1.1	0.1	1.2	1.0	0.0	1.0
Computers and office machines	84_s3	10.6	1.4	11.9	-3.0	-0.2	-3.1
Other 84	84_s4	1.9	0.2	2.0	0.0	-0.1	0.0
Electric motors and appliances	85_s1	6.4	0.2	6.5	-2.2	0.0	-2.1
Radio, recording equipment	85_s2	10.5	0.3	10.7	-4.1	0.3	-3.8
Television equipment	85_s3	2.3	0.0	2.3	2.3	0.3	2.6
Circuits and components	85_s4	6.9	0.1	7.0	-3.5	0.0	-3.5
Wire and cables	85_s5	3.0	0.1	3.1	-1.5	0.0	-1.5
Railway equipment	86	0.6	0.0	0.6	-0.1	0.0	-0.1
Motor vehicles for transport of persons (except buses)	8 703	11.4	1.0	12.4	-4.3	-0.2	-4.6
Motor vehicles for the transport of goods	8704	4.9	0.0	4.9	0.1	0.1	0.1
Parts and accessories for motor vehicles	8708	3.6	0.0	3.6	0.6	0.1	0.8
Other 87	87oth	0.4	0.1	0.5	-0.1	0.0	-0.1
Aircraft and ships	88_89	0.1	0.1	0.2	0.0	0.0	0.0
Optical and precision equipment	90_92	3.4	0.1	3.5	0.3	0.2	0.5
Toys, furniture and miscellaneous	93_96	3.0	0.1	3.1	-0.5	0.0	-0.6
	Total	88.7	3.3	92.0	-19.5	1.1	-18.4

Source: OECD Calculations, OECD International Trade by Commodity Statistics.

Table A1.3. Breakdown of the market share effect

	HS (1988) category	1994-2000			2001-2006		
		USA	Rest of the world	Total	USA	Rest of the world	Total
Prepared food	16_24	1.4	0.4	1.7	0.3	0.0	0.3
Chemicals, rubber and plastics	28_40	0.9	0.1	1.0	-0.9	0.1	-0.8
Pulp and paper products	47_49	0.5	0.0	0.5	0.1	0.0	0.1
Textiles	50_59	1.1	0.2	1.3	-0.4	-0.1	-0.5
Clothing and footwear	60_67	7.6	0.2	7.8	-2.8	0.0	-2.8
Articles of stone, cement, glass and jewellery	68_71	0.4	0.1	0.6	0.8	-0.1	0.8
Base metals	72_83	3.0	-0.1	2.9	-0.9	0.3	-0.5
Engines	84_s1	0.5	-0.6	0.0	0.4	-0.1	0.3
Pumps, fridges, heaters and filters	84_s2	0.9	0.1	1.0	0.6	0.0	0.6
Computers and office machines	84_s3	8.1	0.8	8.9	-1.2	0.0	-1.2
Other 84	84_s4	2.0	0.2	2.2	0.4	-0.1	0.3
Electric motors and appliances	85_s1	3.4	0.1	3.5	-1.6	0.0	-1.5
Radio, recording equipment	85_s2	5.3	0.2	5.5	-2.8	0.2	-2.6
Television equipment	85_s3	0.5	0.0	0.5	-1.3	0.2	-1.1
Circuits and components	85_s4	4.4	-0.1	4.4	2.4	0.0	2.4
Wire and cables	85_s5	1.4	0.1	1.4	-0.8	0.0	-0.8
Railway equipment	86	0.6	0.0	0.6	0.2	0.0	0.2
Motor vehicles for transport of persons (except buses)	8 703	8.9	1.3	10.2	-2.2	-0.3	-2.5
Motor vehicles for the transport of goods	8704	4.6	0.0	4.6	1.2	0.1	1.3
Parts and accessories for motor vehicles	8708	4.3	-0.1	4.3	1.1	0.1	1.2
Other 87	87oth	0.3	0.1	0.4	0.0	0.0	0.0
Aircraft and ships	88_89	0.0	0.1	0.0	0.2	0.0	0.1
Optical and precision equipment	90_92	2.6	0.1	2.7	1.2	0.2	1.3
Toys, furniture and miscellaneous	93_96	1.4	0.2	1.6	-0.2	0.0	-0.3
	Total	63.8	3.6	67.4	-6.3	0.6	-5.7

Source: OECD Calculations, OECD International Trade by Commodity Statistics.

Table A1.4 Breakdown of the product structure effect

	HS (1988) category	1994-2000	2001-2006
Prepared food	16_24	-0.5	0.0
Chemicals, rubber and plastics	28_40	-0.1	0.8
Pulp and paper products	47_49	-0.1	-0.2
Textiles	50_59	-0.5	-0.4
Clothing and footwear	60_67	-0.6	-0.9
Articles of stone, cement, glass and jewellery	68_71	-0.3	0.0
Base metals	72_83	-0.8	1.5
Engines	84_s1	0.6	-0.2
Pumps, fridges, heaters and filters	84_s2	-0.2	0.1
Computers and office machines	84_s3	1.3	-1.5
Other 84	84_s4	-0.4	0.0
Electric motors and appliances	85_s1	0.5	-0.4
Radio, recording equipment	85_s2	2.3	0.0
Television equipment	85_s3	-0.3	3.1
Circuits and components	85_s4	4.0	-0.8
Wire and cables	85_s5	1.2	-0.1
Railway equipment	86	0.0	0.0
Motor vehicles for transport of persons (except buses)	8 703	-0.1	-0.8
Motor vehicles for the transport of goods	8704	0.1	-0.2
Parts and accessories for motor vehicles	8708	0.1	-0.1
Other 87	87oth	-0.2	0.0
Aircraft and ships	88_89	0.0	0.0
Optical and precision equipment	90_92	0.1	0.3
Toys, furniture and miscellaneous	93_96	0.0	-0.2
	Total	5.9	0.0

Source: OECD Calculations, OECD International Trade by Commodity Statistics.

Table A1.5. Breakdown of the geographical structure effect

	1994-2000	2001-2006
USA	13.8	-14.7
Rest of World	-0.3	0.3
Total	13.5	-14.4

Source: OECD Calculations, OECD International Trade by Commodity Statistics.

ANNEX A3
LABELLING REQUIREMENTS – STILL AN OBSTACLE TO TRADE

In spite of some improvements in recent years, labelling requirements in Mexico continue to be an issue – UNCTAD's TRAINS database documents labelling requirements as a non-tariff measure for more than 2 500 products out of nearly 12 000 (that is, at the Harmonised System eight-digit tariff line code), from which almost half refer to textiles and clothing. Furthermore, the *EU Market Access* database (http://madb.europa.eu) documents numerous, detailed labelling requirements, which are applied in a very strict and sometimes inconsistent manner for goods such as textiles and alcoholic spirits.[1]

For example, labels must have a certain size and letters to be used must have certain precisely defined typographical proportions. Product information stated in a label in a foreign language has to be identically repeated in Spanish using the same typography, colours, etc., which in many occasions is practically impossible according to EU exporters.

As Mexico's labelling requirements are often different from those set out by the EU, exporters have in most cases to design specific labels for the Mexican market. This represents an additional and unnecessary cost.

An indicator of the extent of the difficulty of compliance with labelling requirements is the revealed preference by importers for using expensive services from private agents, instead of trying to meet the requirements alone. As an alternative to fulfilling the labelling requirements before importation, and in order to avoid problems in customs controls, many importers use the services of Verification Units, which are private entities authorised to control the conformity of labels with the relevant official norms. There is hence a market for label verification. Each "dictamen" (verification of a label) normally costs less than US$ 100, but only covers one product (or a family of similar products) – therefore the verification of a shipment containing different products can represent a non-negligible cost. Furthermore, for products where models change very often (*e.g.* in the clothing industry), those Units do not constitute a cost-efficient solution, because one verification is valid only for a single product.

If importers fail to fulfill the label requirements, sanctions can be imposed, in the form of penalties (ranging from 2% up to 10% of the value of the goods) or even the confiscation of the products.

There is a need for simplification and flexibility in the compliance with labelling requirements at the border (*e.g.* acceptance of analogous terms). Mexico should use recognition of labelling standards, especially with partners where standards are already high, including the European Union or the United States.

1. See the reports: *In-depth analysis of trade and investment barriers in certain third country markets in the area of labelling and marking requirements*, 2002 (pp. 57-80), and *Market Access Analysis to identify and update the existing information on trade barriers in third countries affecting EU exports of textile and clothing, footwear and leather*, 2005 (pp. 110-42), both available at *http://madb.europa.eu*.

ANNEX A4
RESTRICTIONS ON FDI

A. Restrictions on FDI

Trans-sectoral: Acquisitions exceeding a total of 49% of the equity of the Mexican enterprise are subject to review if the total value of the assets of the enterprise to be acquired exceeds US$150 million. Authority: Foreign Investment Law (FIL) 1993.

Activities reserved to the state: petroleum and hydrocarbons (extraction), basic petrochemicals, electricity (supply electric power which is to be used for public service), generation of nuclear energy, radioactive minerals, telegraph, radiotelegraphy, postal service, bank note issuing, minting of coins, control supervision and surveillance of ports, airports and heliports. Authority: Mexican Constitution, FIL.

Real estate: Acquisition of land used for agriculture, livestock or forestry purposes is not permitted. However, "T" shares which represent the value of such land may be purchased by foreign-controlled enterprises up to 49% of the value of the land. Acquisition of land for residential purposes by foreign-controlled enterprises is not permitted. Authority: Mexican Constitution; FIL; Agrarian Law.

Oil and gas: Only Mexican nationals and Mexican companies with a foreigner exclusion clause may engage in retail trade in gasoline and distribution of liquefied petroleum gas. Participation in the supply of fuels and lubricants for ship, aircraft and railroad equipment may not exceed a total of 49% of equity. Investment in the construction of oil pipelines and other derivative products and oil and gas drilling may be authorised above a total of 49% of equity. Authority: FIL; Reglementary Law to Article 27 of the Mexican Constitution in the Oil Sector and its Regulations; Regulations on Gas Distribution.

Fishing: Foreign investment is permitted up to 49% in fishing in coastal and fresh waters or in the Exclusive Economic Zone and up to 100% in aquaculture. Authority: FIL, Fisheries Law.

Financial institutions: Foreign investment may participate in the following activities:

a) Ownership up to a total of 49% of the paid-in capital in insurance companies, financial leasing companies, factoring companies, limited scope financial institutions (Sofoles), general deposit warehouses, bonding companies and foreign exchange firms. Financial leasing and factoring were liberalised in July 2006; therefore the 49% limit – and the 51% limit for subsidiaries – only applies to leasing and factoring companies already established by that date. Credit had already been liberalised; therefore, the same applies for Sofoles. By July 2013, all of these companies will have to transit to the deregulated regime.

b) Ownership of up to a total of 100% of the common stock in credit information institutions, securities advisory companies, mutual funds and securities rating agencies.

c) Ownership of at least 51% of the common stock in a subsidiary of the following type: bonding companies, general deposit warehouses, foreign exchange firms, pension funds and managing companies, by non-resident financial institutions of the same general type of activities.

d) Ownership of at least 51% of the common stock in a subsidiary of managing companies of investment companies, and of the fixed stock of investment companies, by non-resident financial institutions of the same general type of activities.

e) Ownership of at least 51% of the common stock in a subsidiary of the following type: banks, securities firms, insurance companies.

f) Ownership of at least 51% and up to a total of 100% of the common stock of existing financial institutions, irrespective of any individual size limits or aggregate market share limits, provided an authorisation is granted.

Authority: FIL, Credit Institutions Law; Law for the Regulation of Financial Groups; Stock Market Law; General Law for Credit Organisations and Auxiliary Activities; Federal Bonding Institutions Law; Insurance Institutions General Law; Investment Companies Law.

Air transport and related services: Foreign investment is permitted up to a total of 25% in national air transport, specialised air services and aero-taxi services and up to a total of 49% of equity in the administration of air terminals. Full ownership may be authorised in the administration of air terminals. Authority: Mexican Constitution; General Means of Communication Law; FIL; Law on Nationality.

Ground transport and related services: Domestic land transport for passengers, tourism and freight, not including messenger or courier services is reserved to Mexican nationals. Foreign investment in the international ground transport of passengers, tourism and loading and in the administration of bus stations for passengers and auxiliary activities within Mexico is allowed up to 49% of equity. This share will increase to 51% as of 1 January 2001 and up to 100% as of 1 January 2004. Foreigners may participate up to 49% in a railway concessionaire enterprise without authorisation and above 49% subject to authorisation. Authority: FIL; General Means of Communication Law; Law on Nationality.

Maritime transport and related services: Foreign investment is permitted up to a total of 49% of equity in interior navigation and coastal sailing – other than tourist cruises and the exploitation of dredges and other naval devices for ports where foreign investment is permitted up to 100% – in integral port administration and port pilot services for interior navigation; foreign investment may be authorised up to 100% in foreign commerce shipping and port services pertaining to interior navigation. Authority: Mexican Constitution; FIL; Law on Navigation; Law of Ports; Law on Nationality.

Radio and television broadcasting: Radio and television broadcasting (excluding cable television) are reserved to Mexican nationals and Mexican companies with a foreigner exclusion clause. Foreign investment through a Mexican corporation is permitted up to 49% of equity in cable television. Authority: Radio and Television General Law; Regulations of Cable Television; FIL and its Regulations.

Telecommunication services: Foreign investment in the telecommunications sector is permitted up to 49% of equity through a Mexican corporation, except in cellular telephony where foreign investment may be authorised above a total of 49% of equity. Investment in videotext and enhanced packet switching is free. Authority: Regulations to the FIL.

Newspapers: Foreign investment in newspapers for exclusive internal circulation may not exceed a total of 49% of equity. Authority: FIL.

Legal services: Investment by foreign nationals in legal services exceeding 49% of equity, unless an authorisation is granted. A professional license in law is required to be a public notary or a commercial public notary. Only a Mexican national by birth may be licensed as a public notary or a commercial public notary. Neither a public notary, nor a commercial public notary may have a business affiliation with any person who is not licensed in the same category of public notary.

Education services: Investment by foreign nationals in private education services cannot exceed 49% of equity, unless an authorisation is granted.

Sources: FIL, Mexican Constitution and OECD (2007), *Adhering Country Exceptions to National Treatment for Foreign Controlled Enterprises*, Paris.

B. OECD FDI restrictiveness index

The OECD FDI regulatory restrictiveness index (OECD, 2006c) measures deviation from "national treatment", *i.e.* discrimination against foreign investment. It takes into account discriminatory barriers to entry including foreign ownership limitations, special screening procedures applied to foreign investors as well as post-entry management and operational restrictions. Scores range from 0 (full openness) to 1 (*de facto* prohibition on FDI). Overall on this measure Mexico is one of the most restrictive countries in the OECD and also is more restrictive than other countries outside the OECD such as Argentina, Brazil and Chile. The following table gives Mexico's scores compared to the OECD average by sector. Mexico is particularly restrictive compared to the OECD average in accounting, fixed-line telecommunications, insurance and banking, air and maritime transport, and electricity.

	Mexico	OECD Average
Business Services	0.206	0.152
Legal	0.150	0.221
Accounting	0.425	0.196
Architecture	0.125	0.094
Engineering	0.125	0.094
Telecoms	0.356	0.184
Fixed	0.425	0.198
Mobile	0.150	0.143
Construction	0.125	0.076
Distribution	0.125	0.072
Finance	0.502	0.152
Insurance	0.425	0.135
Banking	0.525	0.157
Hotels and Restaurants	0.125	0.072
Transport Total	0.428	0.299
Air	0.625	0.443
Maritime	0.424	0.280
Road	0.125	0.106
Electricity	1.000	0.326
Manufacturing	0.125	0.076

WORKING PAPERS

The full series of Economics Department Working Papers can be consulted at www.oecd.org/eco/Working_Papers/

656. *How do taxes affect investment and productivity? An industry-level analysis of OECD countries* (December 2008) Laura Vartia

655. *Strategies for countries with favourable fiscal positions* (November 2008) Robert Price, Isabelle Joumard, Christophe André and Makoto Minegishi

654. *Monetary transmission mechanism in Central and Eastern Europe: Surveying the Surveable* (November 2008) Balázs Égert and Ronald MacDonald

653. *An Overview of the OECD ENV-Linkages Model* (December 2008) Jean-Marc Burniaux and Jean Château

652. *Reforming the labour market in Japan to cope with increasing dualism and population ageing* (November 2008) Randall S. Jones

651. *Enhancing the productivity of the service sector in Japan* (November 2008) Randall S. Jones and Taesik Yoon

650. *Reforming the tax system in Japan to promote fiscal sustainability and economic growth* (November 2008) Randall S. Jones and Masahiko Tsutsumi

649. *What Drives the NAIRU? Evidence from a Panel of OECD Countries* (November 2008) Christian Gianella, Isabell Koske, Elena Rusticelli and Olivier Chatal

648. *Short-term distributional effects of structural reforms: selected simulations in a DGSE framework* (October 2008) Annabelle Mourougane and Lukas Vogel

647. *Speed of adjustment to selected labour market and tax reforms* (October 2008) Annabelle Mourougane, Lukas Vogel

646. *The challenge of monetary policy in Turkey* (October 2008) Olcay Çulha, Ali Çulha and Rauf Gönenç

645. *Improving cost-effectiveness in the health-care sector in Iceland* (October 2008) Hannes Suppanz

644. *Understanding Russian regions' economic performance during periods of decline and growth – an Extreme Bound Analysis approach* (October 2008) Rüdiger Ahrend

643. *Do tax structures affect aggregate economic growth? Empirical evidence from a panel of OECD countries* (October 2008) Jens Arnold

642. *Accounting for one-off operations when assessing underlying fiscal positions*
(October 2008) Isabelle Joumard, Makoto Minegishi, Christophe André, Chantal Nicq and Robert Price

641. *Do corporate taxes reduce productivity and investment at the firm level? Cross-country evidence from the Amadeus dataset*
(October 2008) Cyrille Schwellnus and Jens Arnold

640. *The challenge of rapidly improving transport infrastructure in Poland*
(September 2008) Rafal Kierzenkowski

639. *Bridging the housing gap in Poland*
(September 2008), Rafal Kierzenkowski

638. *Improving the business and investment climate in Indonesia*
(September 2008), Diego Moccero

637. *Growth performance and policy challenges*
(September 2008), Luiz de Mello

636. *A taxonomy of instruments to reduce greenhouse gas emissions and their interactions*
(September 2008), Romain Duval

635. *Quantifying the effect of financial conditions on US activity*
(September 2008) Stéphanie Guichard and David Turner

634. *Have long-term financial trends changed the transmission of monetary policy*
(September 2008), Stéphanie Guichard and David Turner

633. *Raising education achievement and breaking the cycle of inequality in the United Kingdom*
(August 2008) Anne-Marie Brook

632. *The euro changeover in the Slovak Republic: implications for inflation and interest rates*
(August 2008) Felix Hüfner and Isabell Koske

631. *Tax reform for efficiency and fairness in Canada*
(August 2008) Alexandra Bibbee

630. *Reforming the Polish Tax System to Improve its Efficiency*
(August 2008) Alain de Serres

629. *Modernising Canada's Agriculture Policies*
(August 2008) Peter Jarrett and Shuji Kobayakawa

628. *Recent trends and structural breaks in US and EU15 labour productivity growth*
(August 2008) Laure Turner and Hervé Boulhol

627. *Health Status Determinants: Lifestyle, Enviroment, Health Care Resources and Efficiency*
(August 2008) Isabelle Joumard, Christophe André, Chantal Nicq and Olivier Chatal