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**NAVAL WAR COLLEGE  
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**Competition and GDP Growth:  
The Mexican Solution**

**by**

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**CDR USN**

**A paper submitted to the Faculty of the Naval War College in partial satisfaction of the requirements of the Department of Joint Military Operations.**

**The contents of this paper reflect my own personal views and are not necessarily endorsed by the Naval War College or the Department of the Navy.**

**Signature: \_\_\_\_\_**

**28 October 2011**

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## **ABSTRACT**

### *Competition and GDP Growth: The Mexican Solution*

The relationship between competition and Gross Domestic Product (GDP) influences the health of an economy. The understanding of how GDP growth can be utilized to determine a country's economic health is important because it allows a government to make fiscal adjustments when necessary. When those adjustments are made, sufficient regulation must follow in order to ensure a competitive environment is maintained in the respective market sector. This paper argues that Mexico is not reaching its GDP growth potential because of non-competitive practices in private industry due to ineffective policy and regulation. Examples are given to illustrate the loss of private sector GDP growth potential. This paper also concludes that in order to reach its GDP growth potential, Mexico must first introduce greater competition into its state-owned industry by privatizing the energy sector. Examples of Latin American countries who have successfully accomplished the transition of privatization are given to provide a basis for this conclusion.

## INTRODUCTION

The growth of the Mexican economy is not meeting its potential. Currently, private and public industries in Mexico operate under a system of inefficient regulation and monopolistic control which in turn, hampers investment, innovation and growth.<sup>1</sup> A market that is poorly regulated does not produce a competitive environment, which directly influences the growth of that economy.<sup>2</sup> In order to maximize its Gross Domestic Product (GDP) growth, the Mexican government must introduce greater competition into both the private and public industry sectors.

Gross Domestic Product is important because it is a primary statistic used by economists to determine what is required to either stimulate or restrain the economy. The measurement of GDP is so important that the United States, having the world's largest per capita GDP (purchasing power parity), calculates its GDP every month in a report published by the Department of Commerce's Bureau of Economic Analysis.<sup>3</sup> If the country with the world's largest per capita GDP scrutinizes this measurement so closely, Mexico should as well.

Mexico however, continues to impede its GDP growth by allowing its industry to function under an umbrella of ineffective policy and improperly regulated markets. Because of this misguided policy, the privately owned and state-run industries are limited in meeting Mexico's GDP growth potential. Comparing the average GDP of Mexico (1.8%) to East Asia's (5.1%) over the past 47 years illustrates this point. Over this time frame, Mexico has

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<sup>1</sup> Javier Arias et al., *Policies to Promote Growth and Economic Efficiency in Mexico* (Bonn: Institute for the Study of Labor, 2010), 4.

<sup>2</sup> Nick Godfrey, "Why is Competition Important for Growth and Poverty Reduction", last modified March 2008, <http://www.oecd.org/dataoecd/47/14/40315399.pdf>.

<sup>3</sup> Central Intelligence Agency World Fact Book, Central Intelligence Agency, last modified October 2011, <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2001rank.html>.

attempted to adjust its policies but the reforms implemented have been unsuccessful in creating significant economic improvement.<sup>4</sup>

Recent anti-trust legislation passed by the Mexican government proves that Mexico is trying to stimulate its economy by increasing competitive practices throughout several sectors. In the private sector, the government must not only continue to improve its competition law but must also provide its regulatory body, the Federal Competition Commission (CFC) with broader powers. In regard to the public sector, Mexico must follow the example of other Latin American countries and privatize its energy sector. In doing so, greater GDP growth can be realized.

### **THE IMPORTANCE OF GDP**

Gross Domestic Product is defined by the World Bank as the total “value of all final goods and services produced in a country in one year.”<sup>5</sup> Economists around the world use this measurement for several reasons, primarily to compare the economic growth and production of a particular country. They also use the change in GDP percentage to predict the future health of an economy. In general, a positive trend toward a greater GDP equates to a healthier economy with more jobs and higher wages for the people. Higher wages leads to spending which creates a higher standard of living. An increase in the standard of living for a population generally means a healthy, growing economy.

GDP is also used to compare the size of economies throughout the world. A GDP comparison of countries with similar economic characteristics allows a country to determine how competitive they are with other nations. Multiple organizations such as the World Bank

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<sup>4</sup> Arias, *Policies to Promote Growth and Economic Efficiency in Mexico*, 9.

<sup>5</sup> World Bank Group, *Beyond Economic Growth Student Handbook*, last modified 2004.  
<http://www.worldbank.org/depweb/english/beyond/global/glossary.html>.

and the World Economic Forum help countries do this by predicting future GDP levels throughout the world. If Mexico wants to maximize its GDP growth, its leadership needs to be attentive to GDP as a recognized measurement of economic health so they can accurately determine if policy and regulation change is warranted.

### **MISGUIDED POLICY AND REGULATION**

Historically, Mexico develops its economic policy in reaction to the most current economic crisis. The government's reactive policy, aimed at solving short term problems, does not foster an environment for long term competitive practices and GDP growth. Until Mexico takes a more proactive, long term approach in developing its economic policy, it will continue to have an uncompetitive industry that limits GDP growth potential.

Mexico began its initial reform of competition policy in the mid-1980s in an effort to develop a market-based economy. The intent was to end government control and protection of economic activity by discontinuing domestic price controls while reducing entry costs in doing business in Mexico. Import licenses were abolished while tariffs were significantly reduced. Numerous free trade agreements were followed by the signing of NAFTA in 1993. This resulted in annual imports increasing by more than 1000 percent over the next twenty years.<sup>6</sup>

The government also began privatizing the industrial sector. Subsectors in both the manufacturing and service industries were sold to commercially private entities. Banking, steel, sugar, transportation, airlines, and television broadcasting, all previously controlled by

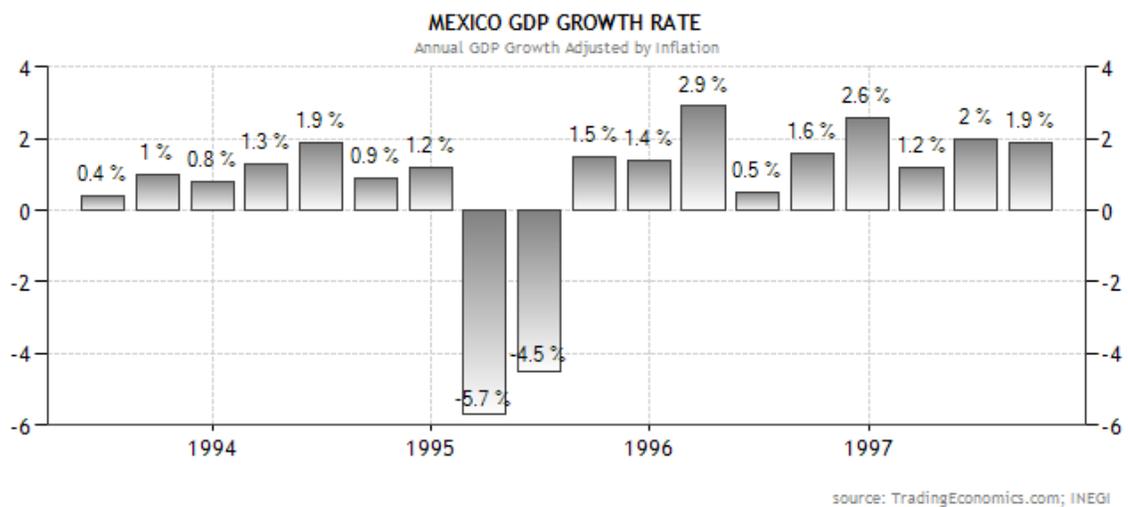
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<sup>6</sup> Jay C. Schaffer, "Competition Law and Policy in Mexico: An OECD Peer Review," OECD Web, last modified October 10, 2011, [www.oecd.org/dataoecd/57/9/31430869.pdf](http://www.oecd.org/dataoecd/57/9/31430869.pdf).

the state, were sold to private investors in order to obtain greater revenue for the Mexican government.

Unfortunately, the privatization of certain subsectors was short lived. Although generally unrelated to privatization, the peso crisis of 1995 caused the Mexican government to reacquire certain sectors in an effort to stabilize the economy. The results of this reacquisition, seen in Figure 1, helped stop the negative GDP growth rate and begin a slow recovery toward positive numbers.

**Figure 1: 1993-1998 GDP Growth Rate**



Although certain sectors were now back under state-control, not all private businesses were reacquired by the government. The industry was now a combination of private and state-owned businesses with insufficient policy to regulate it. This in turn, allowed private investors, such as Carlos Slim, to begin formalizing monopolistic practices in order to increase profits. Realizing that they were creating an environment for monopolistic exploitation, Mexico passed legislation, creating the Federal Law of Economic Competition (LFCE). The law's intent was "to protect the competitive process and free market access by

preventing monopolies, monopolistic practices, and other restraints of the efficient functioning markets for goods and services.”<sup>7</sup>

To enforce this new law, the Federal Competition Commission (CFC) was created. Set up to regulate any practice that could be deemed non-competitive, the intent behind the CFC was good, but overall base support for competition policy within Mexico lagged behind.<sup>8</sup> Although amendments to the Commission’s statutory authority and judicial review process have been made over the years, there remain sectors of the Mexican industry that continue to demonstrate anti-competitive practices. Many of these sectors, in the absence of consistent, enforceable regulation, offer lower quality production coupled with higher fixed prices.

Due to ineffective anti-trust regulation, monopolies and oligarchies exist in the private sector and continue to limit the growth of the Mexican GDP. In a study conducted by the OECD and CFC, 31% of household spending in Mexico were on products supplied from monopolistic or oligarchic markets.<sup>9</sup> This fact is further magnified when we compare Mexico’s competitiveness against other countries of the world. In 2009, Mexico ranked 98<sup>th</sup> in competitive countries around the world, many of which operate in similar marketplaces.<sup>10</sup> Figure 2 illustrates the competitive index of Mexico taken from the World Economic Forum sub index of competitive institutions.

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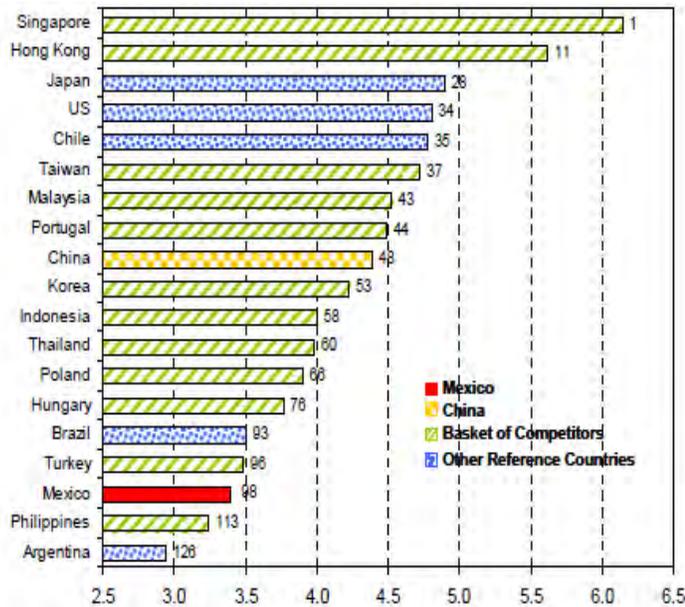
<sup>7</sup> Ibid., 11

<sup>8</sup> Ibid., 12

<sup>9</sup> Directorate for Financial and Enterprise Affairs, Organization for Economic Cooperation and Development, last modified October 2011, [http://www.oecd.org/document/34/0,3343,en\\_2649\\_40381664\\_44948578\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/34/0,3343,en_2649_40381664_44948578_1_1_1_1,00.html)

<sup>10</sup> Daniel Chiquiar and Manuel Ramos-Francia, *Competitiveness and Growth of the Mexican Economy*, Banco de Mexico Working Papers, November 2009, 10.

**Figure 2: Competitiveness Index; Quality of Institutions  
2009-2010**



Source: World Economic Forum (2009).

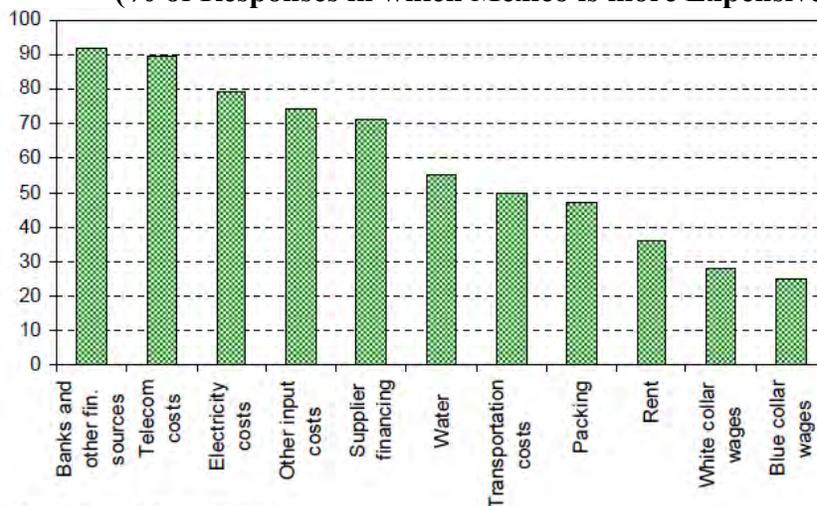
One sector that contributes to this lack of competitiveness is the banking industry. High profitability when compared to the international market combined with high prices for its services lead many to conclude that competition within the banking industry needs to be increased. Approximately two-thirds of the credit market and almost one-half of deposit accounts are controlled by two of the largest banks in Mexico.<sup>11</sup> This high degree of market concentration causes a lack of transparency in services offered, making it very difficult for customers to effectively compare prices or “shop the market.” Furthermore, the major banks highly differentiate their products, making it difficult for the customer to compare services. Even if the customer can determine the difference and compare bank services effectively, the major banks have made the price of switching banks so high that the average customer can’t

<sup>11</sup> The Economist, “Making the Desert Bloom; Mexico’s economy” The Economist, August 27, 2011, <http://www.economist.com/node/21526899>.

afford it. The result is over 95% of the Mexican people have never changed banks and continue to live under oligarchic rules.<sup>12</sup>

Another reason the Mexican banking industry is non-competitive is due to the high cost for new banks to enter the market. In a 2007 survey conducted by Banco de Mexico, 202 firms which made up 50% of the foreign direct investment flow to Mexico were asked which industries were relatively more expensive in Mexico compared to other countries in which they compete. Figure 3 points to Mexico's banking and financial industry as being the highest cost component. These higher costs limit the willingness of foreign banks to invest in the Mexican banking industry, thereby continuing the cycle of limited market choice for the people.

**Figure 3: Production Costs in Mexico vs. Other Countries that Compete for FDI (% of Responses in which Mexico is more Expensive)**



Source: Banco de México (2007a).

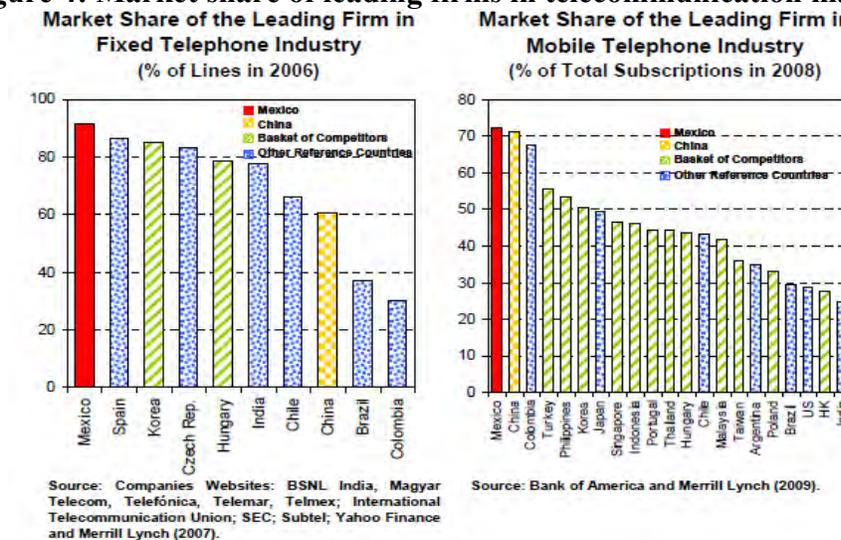
In recent years, the Mexican banking industry has attempted to foster greater competition. Using Mexico's anti-trust agency, the government increased transparency concerning interest rates and commissions. In 2009, the Senate approved pro-competitive

<sup>12</sup> Ibid., 1.

banking reform in an effort to more evenly distribute the credit and debit card market share amongst more banks.<sup>13</sup> Although these new regulations improve certain aspects of the banking sector, Mexico’s banking industry continues to maintain oligarchic characteristics that prevent it from contributing more to its overall GDP growth.

Another privately operated industry that hinders GDP growth due to improper regulation is the telecommunication sector. Similar to banking, the telecommunication industry, when compared to the international market, illustrates a sector dominated by few providers, higher prices and lower quality of service. Figure 4 shows the percentage in market share controlled by the leading Mexican firm, Telmex, for both “land lines” as well as mobile telephones. A high market share leads one to believe that a non-competitive telecommunications market exists in Mexico.

**Figure 4: Market share of leading firms in telecommunication markets**

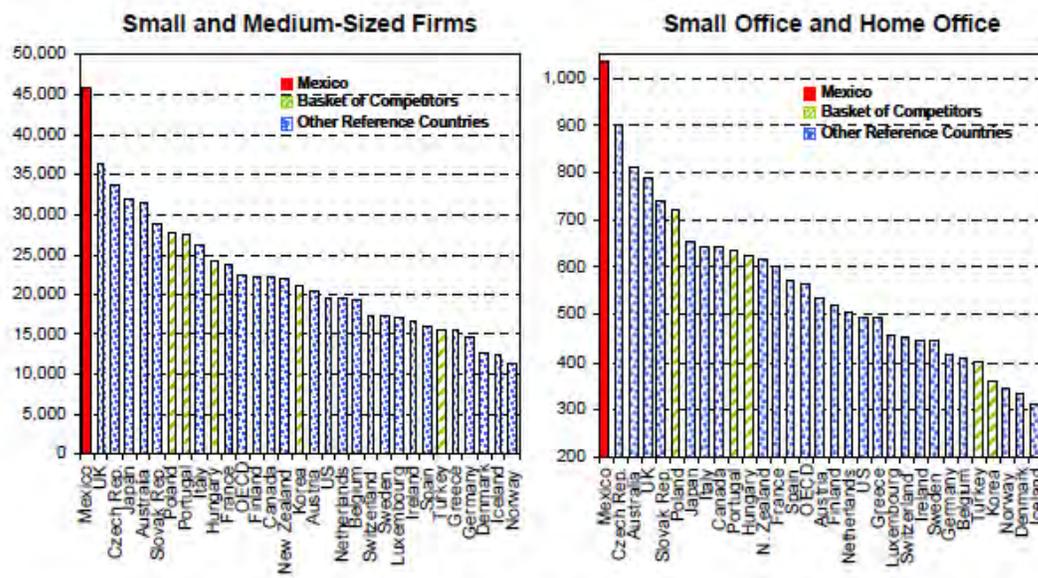


<sup>13</sup> OECD, Directorate for Financial and Enterprise Affairs, [http://www.oecd.org/document/34/0,3343,en\\_2649\\_40381664\\_44948578\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/34/0,3343,en_2649_40381664_44948578_1_1_1_1,00.html)

Carlos Slim is the world's wealthiest man with a net worth estimated to be at \$74.5 billion. Taking advantage of Mexico's "fire sale" of national assets during the Mexican recession of the mid-1980's, Slim built his empire around the telecommunication market. The government's \$6 billion sale of the telephone company Telmex to Slim in 1990 made him the sole provider of telecommunication services in Mexico. Since then he has built the majority of Mexico's telecommunication sector's infrastructure while expanding his company's services to a greater number of people. Because of the high market share controlled by Telmex, the Mexican people have little choice but to buy the services that Carlos Slim sells.

The result is a monopoly of the telecommunications market that fosters high prices and inefficiency. An examination of Mexico's price levels compared to other countries illustrates the first point, as shown in Figure 5.

**Figure 5: Annual Cost of OECD's Business Fixed-Line Basket**



Source: Results from Teligen T-Basket. Copyright Teligen, UK. This telecommunications cost indicators use the OECD basket methodology.

The inefficiency of the sector stems from its lack of reinvestment. Mexico's telecommunication industry has not followed the trend of most other countries in that it lags behind in information technology investment.<sup>14</sup> Both the high prices and inefficiency of the sector reflect the weakness of the regulations put in place to prevent this type of behavior.

Both private sector industries are proof that the private sector needs further competition reform but the state-owned industries in Mexico, particularly the energy sector, need to be addressed as well. Twenty-three years of mismanaged energy policy has resulted in decreased production, higher prices for the consumer, and a regulatory body with no authority.<sup>15</sup> The past four Mexican presidents recognized the importance of the energy sector and attempted to liberalize it to help increase its efficiency. In each case, politics and bureaucratic leveraging overrode the proper regulatory principles that were required. Created during the Carlos Salinas de Gortari administration (1988-1994), the Energy Regulatory Commission (CRE) was initially designed to advise the Ministry of Energy on sector related issues. The intention was to strengthen the functions of the CRE after the reorganization of Mexico's oil company, Petroleos Mexicanos (Pemex). However, bureaucrats and union leaders, fearing a loss of power should privatization occur, pressured Salinas that he postpone giving the CRE any real authoritative power.<sup>16</sup> The oil industry continued business as usual.

The following administration, under Ernesto Zedillo Ponce de Leon (1994-2000), took on a similar approach. With the Mexican government still in recovery from the 1995 peso crisis, Zedillo realized the importance of oil sales to supplement government revenue and instead focused on the electricity sector. Zedillo wanted one entity in charge of

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<sup>14</sup>Daniel Chiquiar and Manuel Ramos-Francia, 49.

<sup>15</sup> Cristopher Ballinas Valdes, *The Future of Oil in Mexico: Taming the Beast Within* "The Mexican Energy Regulatory Commission" (Rice University: James A. Baker III Institute for Public Policy), 31.

<sup>16</sup> *Ibid.*, 23.

supervising the two state-owned suppliers of electricity, the Federal Commission of Electricity (CFE) and Luz y Fuerza del Centro (LyFC). The 1995 Energy Commission Act transformed the CRE from an advisory body into a regulatory agency, overseeing not only energy imports and exports but the transmission and delivery of electricity as well.

Unfortunately, the new legislation didn't strengthen the CRE's powers. Although it claimed to make the CRE autonomous, it still received its budget and board selection approval from the Ministry of Energy. Without the Ministry's approval, the CRE was powerless.

The next two presidential administrations, to include the current one under Felipe Calderon, all took similar approaches. Secondary legislation aimed at "wave top reform" generated minimal effect on the sector, leaving the CRE to be a regulatory body in name only. The CRE's responsibilities still do not include the extraction and refining of oil, the extraction and distribution of natural gas, or the production and distribution of electricity. Responsibilities such as these continue to fall under the laws that govern Mexico's energy sector, many of which can be found coming directly from the Constitution.<sup>17</sup> The result is a state-run regulatory body that is tasked to improve the efficiency of a sector while being restricted by the laws of the nation.

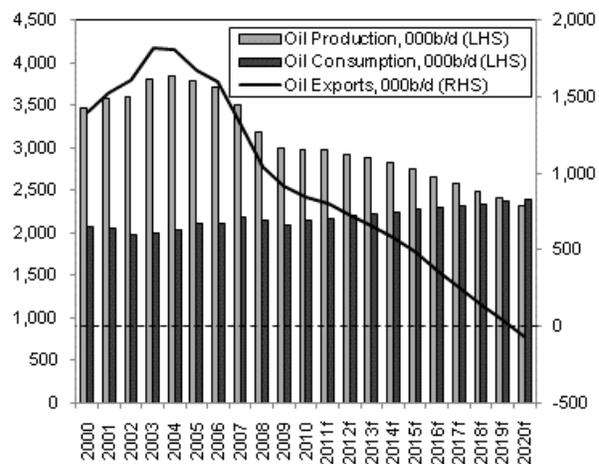
Unfortunately, Mexico uses this inefficient regulatory framework to carry the burden for the entire economy. Its state-run oil and gas producer continues to be a basis for supplying the federal budget with funds needed for development in other sectors of the economy. Taxed heavily by the government to accomplish this, Pemex has little after-tax capital to invest in future infrastructure. The result is a seven year decline in oil production

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<sup>17</sup> Ibid., 16.

coupled with a rise in consumption, as illustrated in Figure 6.<sup>18</sup> At its peak, Mexico’s largest oil field, Cantarell, supplied 60% of the nation’s crude oil. However, from 2005 to 2009 the field dropped production from 2 million barrels per day to approximately 650,000 bpd, resulting in the supply of only 25% of Mexico’s crude oil.<sup>19</sup> Continuing trends such as these do not speak to a successfully run energy sector.

**Figure 6: Mexico’s Oil Production, Consumption and Exports**



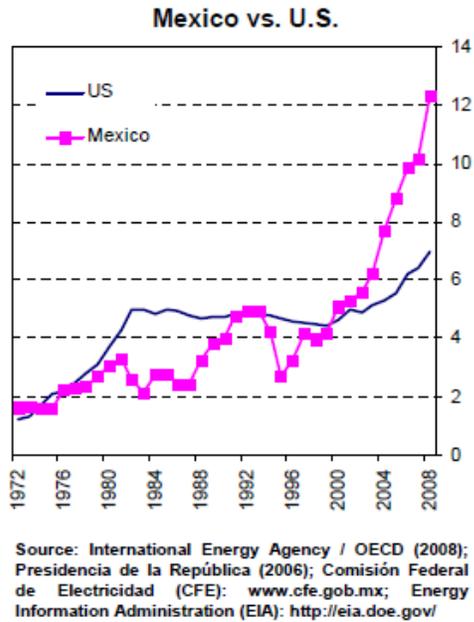
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Management of its oil industry isn’t the only part of the energy sector that has missed the mark. Another sector negatively affecting the potential GDP growth of Mexico is electricity. In the past decade, the price of electricity in Mexico has risen three times faster than the price in the United States, as shown in Figure 7.

<sup>18</sup> Business Monitor International, Mexico Oil and Gas, last modified July 22, 2011, <http://www.businessmonitor.com/cgi-bin/request.pl?view=articleviewer&article=497553&service=2&SessionID=A6F8D5C6FEF611E0B2218C7C434B0CE9&iso=MX&metaid=609>.

<sup>19</sup> Moody’s Investor Service: Credit Opinion Petroleos Mexicanos, last modified December 23, 2009, <http://www.ri.pemex.com/files/content/CO%20Pemex%20091223.pdf>.

**Figure 7: Mean Electricity Prices (US Dollar cents/kilowatt)**



High labor costs, low levels of productivity, and poor quality of service are all factors that affect multiple other industry sectors across Mexico. The result is a reluctance of foreign firms to invest in Mexico due to higher overhead costs related to electricity. Replacement of equipment or loss of production due to more frequent occurrences of power outages and interruptions discourages foreign direct investment (FDI). Less FDI equates to decreased competition in the respective industry, which in turn hinders GDP growth. The energy sector's long history of state ownership and the political leadership's inability to effectively regulate the industry lead one to believe that an introduction of competition into the public sector is the answer to increased GDP growth.

## COMPETITION

The driving force behind markets, competition is the “rivalry between firms in striving to gain sales and make profits.”<sup>20</sup> This should be important to the Mexican government as it develops its future anti-trust reform because it illuminates why businesses exhibit non-competitive behaviors. Making a profit is what drives them, not how they do it. Mexico’s decision making concerning competition policy needs to be interwoven throughout all aspects of the government in order to prevent non-competitive sectors such as the banking and telecommunication industry from emerging.

Wal-Mart de Mexico is a good example of a step in the right direction. In order to give the population a choice, the Mexican government allowed Wal-Mart entry into the banking industry. Focusing on the low-income family, the government hopes Wal-Mart “shakes up that industry as much as it changed the supermarket business when it arrived in Mexico in the 1990s.”<sup>21</sup> The goal is to give the lower to middle-class family a chance at obtaining credit with a financial institution. Because the larger banks normally won’t give credit to lower income families due to fear of delinquent payments, most of the Mexican population has no credit history. Microbanks such as Wal-Mart de Mexico are changing this, giving credit to their faithful customers. This is important because more credit generally leads to greater purchasing power, which in turn leads to more goods purchased and a boost to GDP.

In May of 2011, President Calderon signed into legislation a new Competition Law. The law is designed to clarify past procedural deficiencies and lessen the amount of time it

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<sup>20</sup> Godfrey, *Why is Competition Important for Growth and Poverty Reduction*, 3.

<sup>21</sup> Noel Randewich, “Wal-Mart’s Mexico Bank aims at first time savers” Reuters, June 18, 2010, <http://www.reuters.com/article/2010/06/18/walmart-mexico-idUSN1812635420100618>.

takes to prosecute those who violate the law.<sup>22</sup> The new reform also gives the CFC broader powers to both administer and enforce the new law. Some of those broader powers are: the ability to provide amnesty to individuals, as well as companies who report unfair practices; the ability to impose stronger fines, up to 10% of a company's taxable income; and the ability to press charges against individuals as a criminal offense, with a maximum imprisonment of up to 10 years.<sup>23</sup> Although not conclusive, legislation such as this indicates that Mexico is serious about stimulating its GDP growth by furthering competitive practices in its private sector.

An increase in the GDP through the public sector can be accomplished by the government privatizing its energy sector. With declining oil production and insufficient money being reinvested back into the company, PEMEX can't afford to continually provide the government with almost two-thirds of its revenue. Yet the government refuses to change its course, with PEMEX continuing to make up approximately 30% of Mexico's federal budget.<sup>24</sup> Mexico needs to look for a different way to operate its energy sector before they encounter another economic crisis.

In looking for alternate ways, Mexico doesn't have to look much farther than the examples given by other Latin American countries. Faced with challenges of attracting much needed outside capital during the debt crisis of the 1980's, countries such as Argentina and Brazil began privatizing their state-owned oil industries and eventually developed a stable energy sector. Similar to Mexico, both Argentina and Brazil were using their state-owned

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<sup>22</sup> White and Case, Alert-Mexico Competition Law-Insight, last modified May 2011, <http://www.whitecase.com/alerts-05182011/>.

<sup>23</sup> Ibid., 1.

<sup>24</sup> Business Monitor International, Market Overview Quarter Four, last modified October 20, 2011, <http://www.businessmonitor.com/cgi-bin/request.pl?SessionID=901C0EA0FEFA11E0930597B558700423&view=articleviewer&article=533531&service=2&iso=MX&metaid=192>

energy sector revenue to bolster the development of their country's domestic industry. Following the debt crisis, both countries found themselves confronted by increasing deficits, bureaucratic interference, and little capitalization to reinvest.<sup>25</sup>

Argentina's approach in solving this dilemma was arguably the most aggressive in privatizing its state-run energy sector. Within four years, from 1989-1993, the Argentinean government changed its energy legislation, sold 45% of its shares of Yacimientos Petroliferos Fiscales (YPF) in a public offering, and began the sale of development rights of its oil fields and refineries.<sup>26</sup> Privatization of the electricity sector followed shortly after, along with a new regulatory body created to monitor the new framework of the industry. What made this transformation even more incredible was that the president who led the privatization charge was from the same party that had nationalized Argentina's energy sector over eighty years prior. The success of YPF's privatization is seen today. With private reinvestment and exploration capital available for use, the company announced in May 2011 its largest discovery of oil in over two decades.<sup>27</sup>

Brazil's Petroleo Brasileiro, or Petrobras, operating as a state-controlled monopoly for over forty years took a less aggressive approach. Although the state still controls almost two-thirds of the company's traded shares, it opened its doors to private investment in 1997 and has since become one the largest and most successful oil producing companies in the world.<sup>28</sup> In 2006, Brazilian President Luiz Inacia Lula da Silva declared Brazil self-sufficient on oil,

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<sup>25</sup> Diane Preston, "Privatization of Energy in Argentina and Brazil: A Roadmap for Developing Countries," HeinOnline Web, last modified 1996, [http://heinonline.org/HOL/Page?handle=hein.journals/admin48&div=60&g\\_sent=1&collection=journals](http://heinonline.org/HOL/Page?handle=hein.journals/admin48&div=60&g_sent=1&collection=journals).

<sup>26</sup> *Ibid.*, 653.

<sup>27</sup> Rodrigo Orihuela, "YPF makes Argentina's Largest Oil Discovery in Two Decades," *Bloomberg Businessweek*, May 11, 2011, <http://www.businessweek.com/news/2011-05-11/ypf-makes-argentina-s-largest-oil-discovery-in-two-decades.html>.

<sup>28</sup> Ricardo Geromel, "Interview with Gabrielli: Petrobras CEO and Oil Executive of the Year," *Forbes*, October 11, 2011, <http://www.forbes.com/sites/ricardogeromel/2011/10/11/interview-with-gabrielli-petrobras-ceo-and-oil-executive-of-the-year/>.

largely in part due to the privatization of the industry. Petrobras provides an example of how even partial privatization can create enough competition to enable successful GDP growth. The state still controls the majority of Petrobras' assets, but by opening the company to private investment, Brazil was able to garner the capital needed for its sustainable future and make it one of the fastest growing emerging economies in the world.<sup>29</sup>

### **COUNTER-ARGUMENTS**

There are those who believe that anti-trust regulation, not competition in itself, is the key to stimulating GDP growth in the economy. Mexican officials would argue that they have made the correct policy changes to properly regulate the industry but the changes have not had sufficient time to take effect. The contention is that the new competition law passed in May 2011 is “sweeping and historic in its reach” and will enable the government to stop monopolistic business practices in the manufacturing and service industries.

The problem with this argument is that it applies only to the private sector. The recently passed anti-trust legislation may improve competition in the private sector, but the state-owned sectors are not affected, because with a state-owned enterprise, competition is non-existent. In other words, one cannot regulate competition when it isn't there to start with. Instead, Mexico “regulates” its state-owned sectors with agencies who have little power to correct the ineffective policies administered by the government. The decrease in oil production in the energy sector is an example of Mexico's failure to provide policy that enables growth of its GDP. Increasing anti-trust regulation in the private sector does not address the failure to regulate the public sector.

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<sup>29</sup> Trading Economics, Brazil GDP Growth Rate, last modified 2011, <http://www.tradingeconomics.com/brazil/gdp-growth>.

Others argue that trying to privatize the energy sector is unrealistic because of its relationship with the Mexican population. They argue that the nationalistic pride the population has with oil is too deeply imbedded in the culture of Mexico and that the people of Mexico don't desire privatization. In a 2007 survey, hundreds of thousands of Mexicans were asked whether private companies should be able to participate in the production, transportation, storage and refining of oil resources. A resounding 87% responded "NO" in their answer. When asked whether the initiatives being discussed in Congress concerning energy reform should be approved, 84% responded "NO" as well.<sup>30</sup> Critics conclude that answers such as these speak to the population's nationalistic pride in oil as a barrier to privatization.

The problem with this argument is that it doesn't address how pride is generally overcome by the basic needs of a population. If the state-owned sectors of the Mexican economy continue to be monopolistically run, the basic needs of the general population will eventually be affected. The lack of production in the oil industry and the government's dependence on oil are the facts that generate this conclusion. Once the oil revenue is no longer available, the government will eventually need to draw revenue from other parts of its industry in order to continue to feed its budget. In the end, the people of Mexico are will suffer financially under this "borrow from Peter to pay Paul" type system. One can argue that the population's "nationalistic" pride will disappear when they can no longer provide for their families.

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<sup>30</sup> Manuel Perez-Rocha, "Mexico's Oil Referendum," Foreign Policy in Focus, last modified August 6, 2008, [http://www.fpiif.org/articles/mexicos\\_oil\\_referendum](http://www.fpiif.org/articles/mexicos_oil_referendum).

## **CONCLUSIONS and RECOMMENDATIONS**

Mexico's potential for GDP growth within its public and private sectors is being limited due to a lack of competition. This lack of competition is partially due to Mexico not recognizing GDP's importance and that GDP and competition are interrelated. Once Mexico understands that competition results in higher GDP growth, they will be able to more accurately understand the health of its economy. A greater GDP growth generally equates to a higher standard of living which is a good indicator of economic health. A secondary benefit to Mexico understanding GDP's importance is it will enable a comparison to similar countries in the world. Comparisons are also good indicators into the health of one's economy.

A description of Mexico's deficiencies in policy and regulation were covered, where specific examples of industry sectors that inhibit GDP growth through non-competitive practices were provided. The state-owned energy sector was examined and critiqued, providing the background for why it does not contribute more to GDP growth. Because Mexico uses the energy sector as a crutch to fund its federal budget, reinvestment back into the sector is insufficient. With little reinvestment back into the sector, Mexico's GDP growth potential is never realized.

Lastly, an examination of recent regulatory changes and their progress was done in order to provide some perspective on how far the government of Mexico needs to go to instill more competition and increase its GDP. Examples of past success stories in privatizing the energy sector were given to prove the feasibility of Mexico making the change.

The first step in Mexico reaching its GDP growth potential needs to be the instillation of greater competition into its industry. The most effective way it can do this is by

privatizing its energy sector. Whether it follows Brazil and only partially allows private investment or whether it follows Argentina's example of full privatization is not the issue. The issue is that its overall GDP growth is being negatively affected due to zero competition and ineffective regulation. Because the political and bureaucratic entities within Mexico do not properly regulate the industry, competition through privatization should be Mexico's first course of action. In order to stimulate growth, privatization of the energy sector must be the priority, not further regulation.

The second thing Mexico must do to reach its GDP growth potential is to continue to increase the competitiveness in the private sector. It can accomplish this through stricter regulation and additional anti-trust policy. The CFC's \$1 billion fine of Carlos Slim in April of 2011 indicates Mexico's seriousness in trying to accomplish this but more needs to be done. Mexico must continually develop policy that looks to break down the barriers that harm innovation, productivity, and the growth of an economy. More competition law is good but it has to be supported by effective regulatory enforcement.<sup>31</sup> Mexico must be aware of any legislation that might indirectly affect competition and understand the risks of passing such laws. Should the government heed this advice, competition will increase and GDP growth potential will be realized.

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<sup>31</sup> Godfrey, *Why Is Competition Important for Growth and Poverty Reduction*, 11.

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