

## Improving business environment and investment

REVIVING INVESTMENT IS KEY TO BOOST GROWTH, JOBS AND INCOMES

- ▶ Investment remains weak, dampening growth, formal job creation and wages.
- ▶ International rankings signal that while Mexico has made significant efforts, there is room to improve regulations at regional and local levels.
- ▶ Pursuing the fight against corruption is also key to boost investment and reduce informality, inequality and organised crime.
- ▶ Like in other OECD economies, SMEs are the predominant form of business in Mexico and are hampered by complex regulations and a weak business environment. There is also room to boost their adoption of digital technologies, which is below the OECD average. A solid competition enforcement regime and stable and predictable regulations help attracting investment. The independence of economic regulators supervising key markets is an essential ingredient to ensure policy predictability.
- ▶ The OECD has been supporting Mexico's ongoing efforts to improve the business environment and tackle corruption. Additional support could focus on advancing integrity policies and improving regulations at the local level, SME adoption of digital technologies, and implementation of anticorruption reforms. In Mexico, only 7% of SMEs carry out e-commerce, compared to the OECD average of 22%.

### What's the issue?

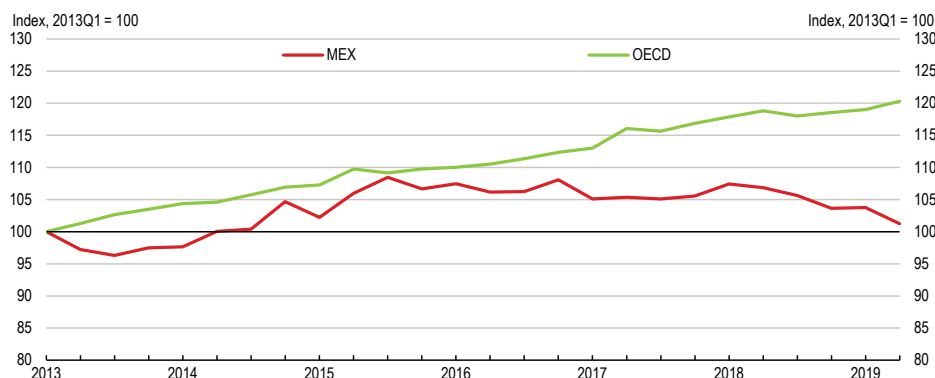
The Mexican economy has experienced a strong transformation. It has become increasingly integrated in Global Value Chains, particularly in manufacturing, and its export basket has become increasingly sophisticated and diversified. Between 1990 and 2016, Mexico almost doubled its trade as a percentage of GDP, from 38% to 76%. Mexico is also the second largest hub by number of start-ups in Latin America, right after Brazil.

However, economic growth remains subdued, as investment has been weak since 2015 (Figure). Low investment dampens

productivity growth and the scope for wages to increase. It also hampers medium-term growth prospects, limiting Mexico's convergence to higher living standards.

International rankings, such as the OECD's Product Market Regulations, signal that there is room to improve regulations to facilitate investment and formal job creation. Recent reforms in key sectors, such as telecommunications and energy, boosted competition, benefiting particularly lower-income Mexicans. In 2016, the government also created a new legal entity through the Commercial Corporations Law:

### » Total investment remains weak



Note: Total investment includes both private and public investment.  
 Source: OECD Economic Outlook 106 database.

the Simplified Actions Corporation (Sociedad por Acciones Simplificadas or SAS), which allows firms to be created within 24 hours through a digital platform, at zero financial cost.

Much progress has also been achieved to improve federal regulations, but regional and local regulations have not followed suit. Mexico has also an extensive system of technical regulations (NOMs), but implementation lags in key sectors. Investment is also hampered by relatively weak institutions, as corruption perceptions are the highest among OECD countries. There is also room to attract more international investment, as restrictions on foreign direct investment are among the most stringent in the OECD.

R&D expenditure in Mexico lags behind, as in Latin America, holding back productivity gains. In Mexico R&D investment was around 0.5% of GDP in 2015, below Latin America (0.7% of GDP) and the OECD (2.5% of GDP). In Mexico, there is little participation of the private sector in R&D as the public sector finances more than 67% of the expenditure, a higher percentage than in the LAC region (60%). Furthermore, weak investment in R&D translates into slow production of original knowledge, as measured by patent applications. In Mexico, each percentage point of GDP invested in R&D produces 4 new patent applications, against 6 patent applications in LAC and 43 in the OECD (OECD et al, 2019).

### Why is this important for Mexico?

A complex regulatory framework can have a detrimental impact on growth, investment and formalization. They particularly hamper the SMEs, which in 2013 accounted for 71% of all persons employed and 37% of value added. In light of the revisions to the North American Free Trade Agreement, which also include a renegotiation of SME policies, public agencies such as INADEM (El Instituto Nacional del Emprendedor)<sup>1</sup> have recently focused on supporting industries that might be more vulnerable to changes, but that also hold high potential for growth and diversification abroad, such as aerospace and machinery.

Regulatory uncertainty, high regulatory costs, and unintended barriers to trade and FDI, can discourage investment or encourage operating in the informal sector. The role of regulators is particularly important, as they contribute to swift implementation of reforms and ensure accountability. Continuing to boost competition is a win-win strategy, as it boosts productivity and reduces prices, which benefits particularly lower-income households. Boosting trust in government is also key, as it facilitates compliance with rules, reducing the cost of enforcement and increasing the confidence of investors.

<sup>1</sup> - INADEM was created in 2013 to streamline SME policy regulations and increase transparency in funding allocation.

### What should policy makers do?

- ▶ Provide clear communication about the path and aims of government policy to help reduce uncertainty and encourage higher investment. Reducing regulatory burden would also be a fundamental step forward.
- ▶ Ensure more innovation and more investments in infrastructure, technology and skills to unleash the potential of Mexican SMEs. This also starts with getting the institutional and regulatory frameworks right.
- ▶ Continue to safeguard the independence of sector regulators, thus enhancing the credibility of their technical decision-making. Keeping their resourcing frameworks stable will be essential. Policy makers should set the bar high in terms of transparency and accountability by the independent regulators.
- ▶ Make efforts to increase competition in procurement processes to strengthen Mexico's competition law and enforcement. The government should reinforce the respect of competition authorities' independence, and implement a fair, effective and manageable enforcement.
- ▶ Pursue the fight against corruption and improve the rule of law to consolidate the implementation of the National Anticorruption System and its guiding documents, such as the National Anticorruption Policy. Providing greater incentives for federal states to advance with the implementation of their local anticorruption systems would help to consolidate efforts. Mexico should also enact comprehensive legislation on whistleblower protections.



### Further reading

OECD (2019), OECD Economic Surveys: Mexico 2019, OECD Publishing, Paris. <https://doi.org/10.1787/a536d00e-en>

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OECD et al. (2019), *Latin American Economic Outlook 2019: Development in Transition*, OECD Publishing, Paris, <https://doi.org/10.1787/g2g9ff18-en>

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OECD/UN (2018), "Production Transformation Policy Review of Chile: Reaping the Benefits of New Frontiers", OECD Development Pathways, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264288379-en> Regulatory Policy in Mexico, Towards a Whole-of-Government Perspective to Regulatory Improvement (2014)

Integrity Review of Mexico: Taking a Stronger Stance against Corruption: <https://www.oecd.org/gov/ethics/oecd-integrity-review-of-mexico-9789264273207-en.htm>.