PROMOTING COMPETITION IN LOCAL MARKETS IN MEXICO

A Subnational Application of the World Bank Group's Markets and Competition Policy Assessment Tool

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List of Abbreviations

COFECE	Federal Economic Competition Commission (*Comisión Federal de Competencia Economica*)
COFEMER	Federal Commission of Better Regulation (*Comisión Federal de Mejora Regulatoria*)
CONAMER	National Commission of Better Regulation (*Comisión Nacional de Mejora Regulatoria*)
FDI	Foreign Direct Investment
FIDEPAR	Trust for the Development of Industrial Parks and Zones in the State of Mexico (*Fideicomiso para el Desarrollo de Parques y Zonas Industriales*)
GDP	Gross Domestic Product
INDECOPI	National Institute for the Defense of Competition and the Protection of Intellectual Property (*Instituto Nacional de Defensa de la Competencia y de la Protección de la Propiedad Intelectual*)
INEGI	National Institute of Statistics and Geography (*Instituto Nacional de Estadística y Geografía*)
LAC	Latin American and the Caribbean
MTI	Macroeconomics, Trade and Investment
MCPAT	Markets and Competition Policy Assessment Tool
SOE	State-Owned Enterprise
TFP	Total Factor Productivity
WBG	World Bank Group

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Acknowledgements

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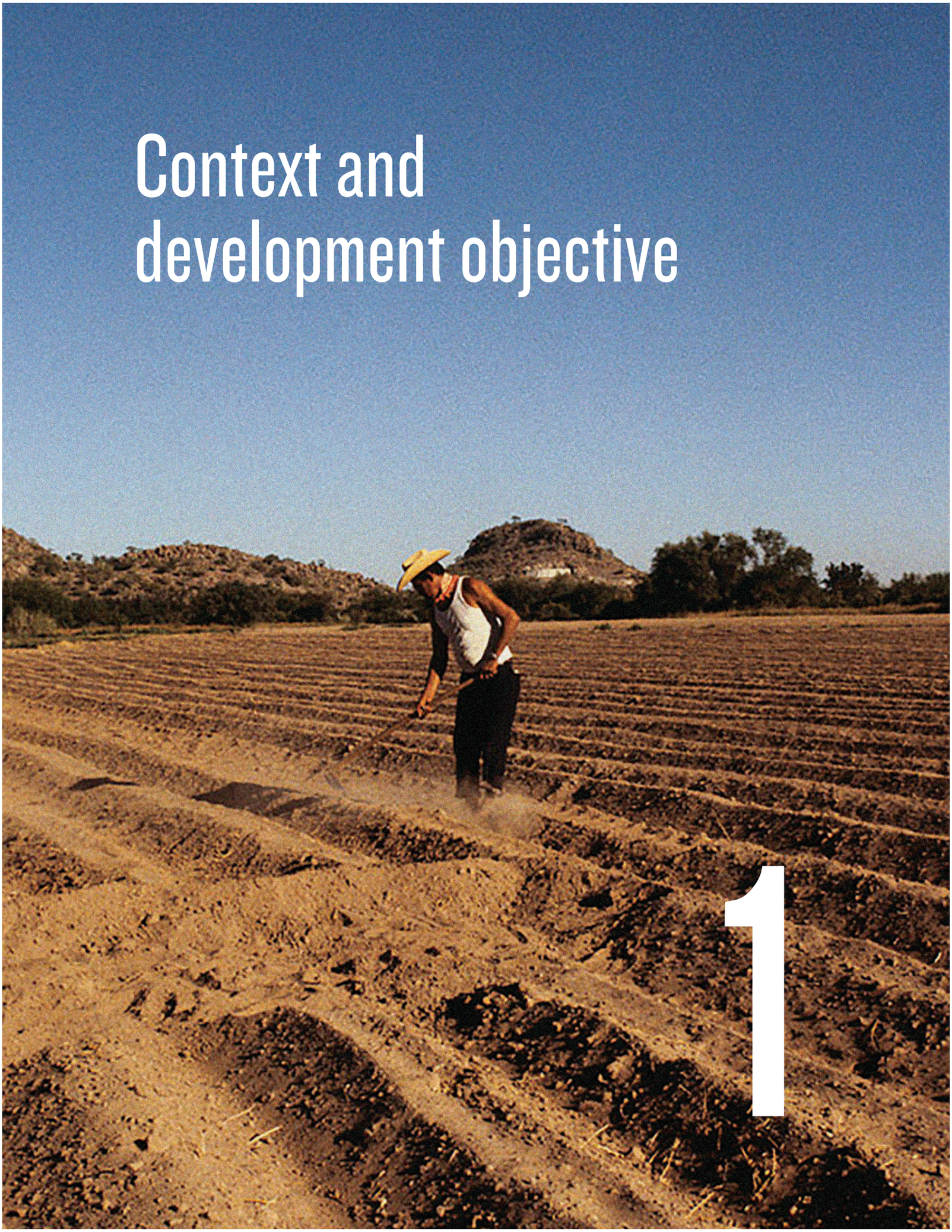
Context and development objective



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Over the past several decades, stagnant productivity growth rates and large disparities in productivity across states have inhibited the growth of the Mexican economy and contributed to regional divergence. Total factor productivity (TFP) has remained broadly unchanged since 1991, as moderate TFP growth in the 1990s and 2010s was wiped out by a sharp contraction in the 2000s. Had productivity continued to grow at the average rate observed between 1950 and 1970, Mexico's GDP per capita would be more than twice its current level. These aggregate statistics mask vast regional differences in productivity growth, as northern states have consistently outperformed southern states. Had the labor productivity of the worst-performing states increased at the same rate as the top performers, their current GDP per capita would be 81 percent higher.[1]

Competition drives productivity growth. Competition both promotes the reallocation of land, labor, and capital toward more efficient firms and encourages all firms to adopt more efficient technologies and business processes. Theoretical and empirical studies show that product market competition boosts innovation,[2] productivity,[3] and economic growth.[4] Moreover, World Bank studies from Tunisia, Argentina, Russia, Turkey, Brazil, and China show that an increase in competition is associated with an increase in productivity at both the firm and the sector level. Simulations suggest that a realistic increase in competition could add between 3.4 and 7 percentage points to annual productivity growth among countries in Latin America and the Caribbean (LAC).[5]

Mexico's federal government has created a solid overall competition policy framework. Mexico's Federal Economic Competition Commission (*Comisión Federal de Competencia Económica, COFECE*) enforces competition law. *Global Competition Review*, a leading antitrust journal, rates COFECE as on par with competition agencies in Chile, Israel, and New Zealand,[6] and COFECE has been recognized internationally for its success in promoting pro-competition reforms.[7] Since 2013, the far-reaching agenda of the Pact for Mexico (*Pacto por México*) set in motion constitutional changes that have overhauled the regulatory framework for the telecommunications sector to boost competition and opened the energy sector to private investment, among other key reforms.

However, competition in local markets remains weak, which undermines economic efficiency and adversely affects consumers, smaller firms, and entrepreneurs. A 2012 World Bank Group (WBG) report highlighted the constraints on competition imposed by state and municipal regulations.[8] For example, subnational regulations[9] on the production of corn flour

1 World Bank (forthcoming).
2 Bassanini and Ernst (2002); Bloom, Draca, and Von Reenen (2011).
3 Aghion and Griffith (2005); Acemoglu et al. (2007).
4 Buccirossi et al. (2009); Voigt (2009). See also: Kitzmuller and Martinez Licetti (2012).
5 Martínez Licetti et al. (2018).
6 In 2014, *Global Competition Review* awarded COFECE 3 out of 5 stars.
7 For example, the Global Advocacy Contest, jointly hosted by World Bank Group and the International Competition Network, recognized COFECE's achievements.
8 World Bank (2013).
9 "Subnational government" refers to all state and municipal authorities. For further details, see: Herrera Gutierrez (2015).

and tortillas, retail fuel sales, retail commerce, and the licensing of overland passenger transportation services often restrict the entry of new firms, facilitate cartel behavior, or discriminate against certain groups of firms. In many municipalities, regulations and government interventions impose minimum distances between outlets, enable incumbents to coordinate prices and deny entry to new firms, or grant incumbents exclusive rights that protect their dominant position. Major obstacles to interstate trade, local monopoly rights, and even regulated price-fixing schemes inhibit the entry of new firms, prevent smaller firms from expanding, and artificially inflate consumer prices.

Regulatory barriers to competition stifle local economic development. Subnational regulations on transportation, agriculture, tourism, retail, and other sectors are slowing the growth of local economies and subverting the power of competitive incentives to reduce consumer prices. Anticompetitive regulations for professionals, such as notaries, further increase the cost of doing business. Subnational regulations on rights of way can also adversely affect the deployment of network services by inflating the costs of network and coverage expansion, especially among mobile operations.

Lack of competition damages Mexico's overall economic performance and exacerbates inequality. The absence of vigorous market competition costs the Mexican economy an estimated 1 percentage point of GDP growth each year, and this finding has been repeatedly confirmed for over a decade.[10] Moreover, this negatively affect the country's poorest households by an estimated 20 percent more than its richest households.

The authorities continue to promote competition and regulatory improvement, but many deficiencies have yet to be addressed. In 2013, COFECE began collecting information on state laws that contain anticompetitive provisions. In 2016, it published a comprehensive compendium of anticompetitive legislation in key sectors,[11] and it publicly called on subnational governments to take corrective action.[12] Meanwhile, the National Commission for Better Regulation (*Comisión Nacional de Mejora Regulatoria*, CONAMER [formerly COFEMER][13]) has continuously advanced the regulatory-improvement agenda at the subnational level based on simplifying, expediting, and otherwise improving generally applicable procedures. CONAMER has successfully promoted numerous reforms via an extensive interinstitutional network at the state and municipal levels, backed by a clear strategy for communicating the economic burden imposed by red tape. However, prior to the joint project with the WBG described below, neither COFECE nor CONAMER had pursued a direct effort to remove sector-specific regulatory barriers at the subnational level.

The Government of Mexico requested assistance from the WBG in addressing sector-specific regulatory barriers at the subnational level through a pilot intervention focused on promoting pro-competition reforms under the framework of the presidential program of *Justicia Cotidiana*. Both COFECE and CONAMER have developed effective tools for implementing competition policy and regulatory-improvement policy, respectively, and the WBG was able to leverage their expertise to ensure that reforms at the subnational level targeted administrative barriers to market entry and regulations that severely distorted competition. An analysis of major regulatory obstacles provided the foundation for a dialogue between the WBG and state and municipal governments, which yielded an actionable reform plan designed to increase competition in key local markets.

Addressing the complex web of regulatory barriers to competition at the local level requires

10 In 2006, the Mexican central bank estimated that imperfect competition shaved 1 percentage point off the annual GDP growth rate. See: *The New York Times* (2006). Chiquiar & Ramos-Francia (2009) reached a similar conclusion, as did a 2015 OECD Economic Survey regarding the potential impact of the pro-competition measures included in the 2012 *Pacto por México*.

11 COFECE (2016a).

12 See: COFECE (2016b); Valadez (2016); Solis (2014).

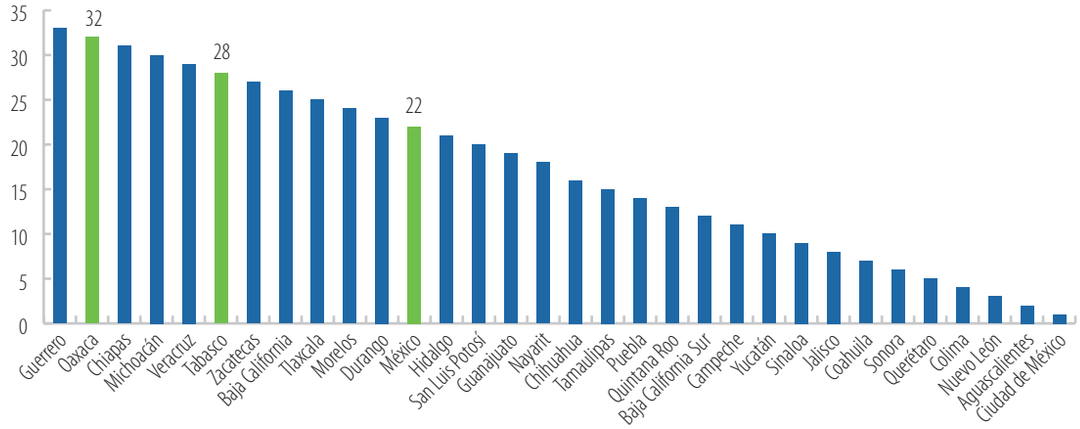
13 According to the General Law on Regulatory Improvement, approved in May 2018, and its 10th transitory provision, the former *Comisión Federal de Mejora Regulatoria* (COFEMER) will now be known as the *Comisión Nacional de Mejora Regulatoria* (CONAMER), and all previous references to COFEMER shall now refer to CONAMER.

a systematic approach. Individually, each barrier is limited in its scope, but together they impose a crippling burden on new market entrants or firms attempting to challenge the power of incumbents. The diffusion of regulatory barriers across legal instruments, sectors and jurisdictions complicates efforts to streamline or eliminate them. Moreover, the harm caused by each regulatory provision depends on how it is implemented and what the features of the affected market are. In addition, some regulatory barriers may be fiercely defended by local vested interests.

Given these challenges, the WBG tailored its Markets and Competition Policy Assessment Tool (MCPAT) to the unique circumstances of Mexico's subnational governments. The MCPAT allows policymakers to systematically identify, prioritize, and address regulatory barriers to competition according to their potential to cause harm and the feasibility of reform. This report discusses the main findings from the WBG's application of the MCPAT across various subnational governments in Mexico, as well as the initial experience of the reform process, by drawing on the results of analytical work and implementation-support projects undertaken since 2012. The analysis and reform effort described in this report ultimately covered all of Mexico's 32 federative entities.[14]

In the reform effort's initial phase, regulatory barriers to competition in Oaxaca State and its capital were identified in the priority areas of retail, transportation, and public procurement. Oaxaca is the third-poorest state in Mexico and ranks at the bottom of the Subnational Competitiveness Index published by the Mexican Institute for Competitiveness (*Instituto Mexicano para la Competitividad*, IMCO) (Figure 1). In applying the MCPAT, the WBG accounted for the specific development challenges facing Oaxaca, including low rates of private-sector job creation. The selection of priority sectors and the design of proposed reforms reflected the potential for increased competition to generate positive spillover effects in other sectors. For example, the WBG supported the Municipality of Oaxaca de Juárez in an effort to reform regulations for retail establishments, especially rules for business hours, which were preventing certain types of businesses from operating successfully in Oaxaca. Following the reform, the largest chain of convenience stores immediately extended its business hours, and another retail chain with a nationwide presence and an innovative business model announced that it would open 24 new outlets in Oaxaca. Overall, the reform is associated with an estimated 6.8 percentage-point increase in the growth rate of annual retail sales.[15]

Figure 1. IMCO Subnational Competitiveness Indicator (2014)



Source: IMCO Ranking.

14 The 32 federative entities (*entidades federativas*) include Mexico's 31 states and Mexico City.
15 Licetti and Dauda (forthcoming).

Figure 2. Number of supermarket chains in municipalities with more-restrictive regulation

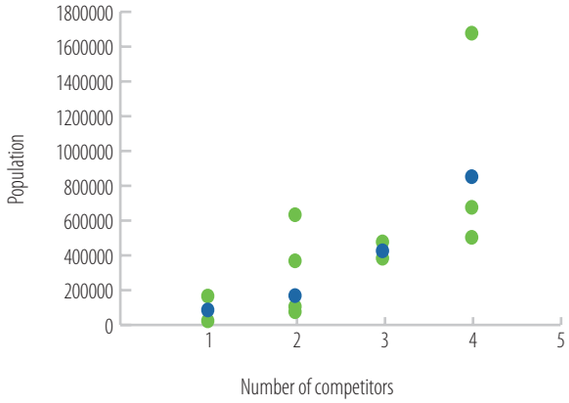
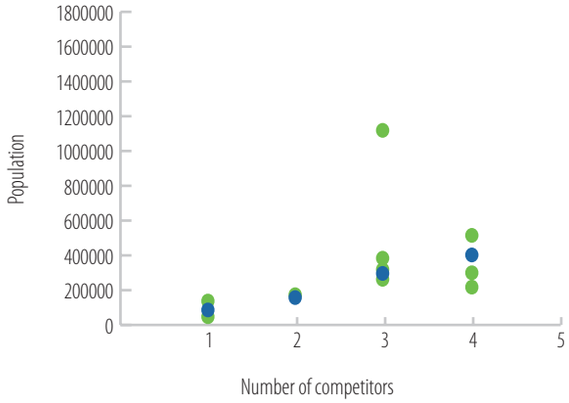


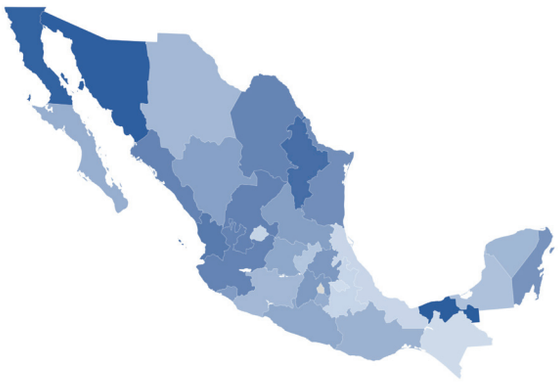
Figure 3. Number of supermarket chains in municipalities with less-restrictive regulation



Note: The green dots reflect individual observations (per municipality) and the blue dots reflect the median value of population figures among all municipalities with the respective number of competitors. **Source**: (Licetti, Goodwin, & Villarán, Combatiendo regulaciones que restringen la competencia a nivel sub-nacional: Estado de Tabasco, México, 2016 b).

In the second phase of the reform effort, the MCPAT's subnational application was replicated in Mexico State and Tabasco. Based on the results achieved in Oaxaca, the governments of Mexico State and Tabasco requested that the MCPAT be applied to their respective legal and regulatory frameworks. Mexico State requested this analysis as part of a comprehensive review of its regulatory framework designed to attract greater investment, and the MCPAT analysis prioritized retail, transportation, and industrial parks. In Tabasco, the Secretary of Economic Development linked the analysis to a larger strategy to diversify the state economy and improve the poor performance of its transportation sector.

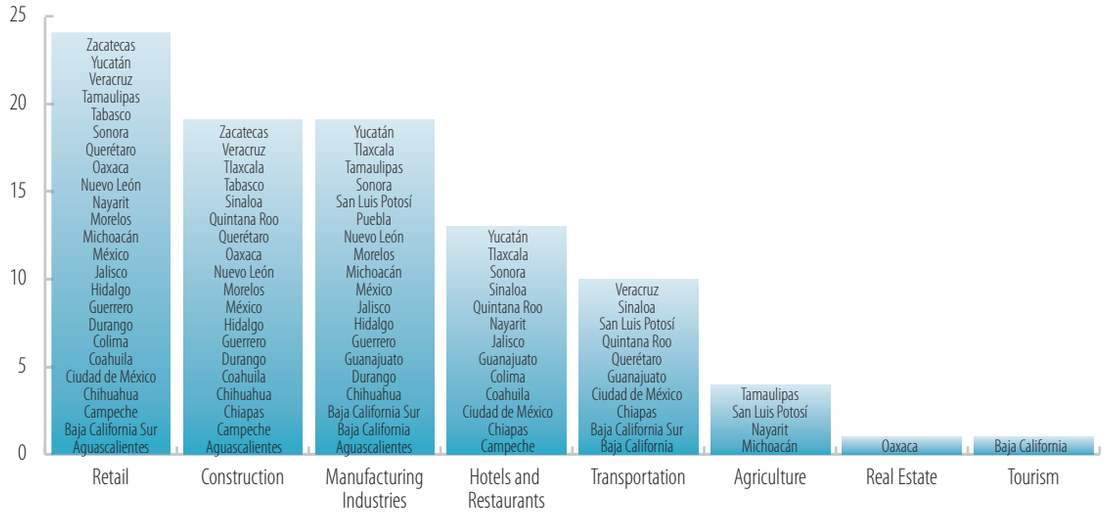
Figure 4. The number of regulatory restrictions identified in key sectors



Source: CONAMER, MCPAT application under Justicia Cotidiana. Note: These are lower-bound figures based on the available information; the actual number of regulatory barriers to competition may be significantly higher. Darker shades of blue reflect a higher number of regulatory restrictions.

A strategic partnership between the WBG and CONAMER was fundamental to the success of the policy dialogue with the state and municipal authorities. This partnership enabled the WBG and CONAMER to work closely with the Mexico State government to eliminate the Regional Impact Judgement (*Dictamen de Impacto Regional*, DIR), a critical regulatory barrier to the establishment of new businesses. All private-sector representatives interviewed in Mexico State identified the DIR—and its susceptibility to discretionary application—as a major concern and reported that in some cases it had delayed market entry or expansion by as much as two years. The assessment revealed that towns in Mexico State that aggressively applied the DIR had fewer supermarket chains per inhabitant, which reduced competition intensity and consumer choice (Figure 2 and Figure 3). The reform replaced the DIR with a simplified approval process to ensure that new establishments adhered to the necessary technical standards. The decree and its bylaws aim to improve regulatory predictability and reduce the scope for discretionary application.

Figure 5. The sectors prioritized for analysis under Justicia Cotidiana



Source: CONAMER, MCPAT application under Justicia Cotidiana.

In the third phase of the reform effort, the MCPAT was embedded in a program under the Everyday Justice (Justicia Cotidiana) presidential initiative, which encompasses all 32 federative entities. Building on the close coordination between CONAMER and the WBG in Mexico State and Tabasco, a presidential decree[16] officially adopted the MCPAT methodology as part of CONAMER's subnational regulatory-improvement agenda that was rolled out under *Justicia Cotidiana*. All 32 federative entities were required to conduct an assessment designed to identify and eliminate subnational regulatory barriers to competition in key sectors, with the WBG as a strategic partner.

The results highlighted the proliferation of anticompetitive regulations at the state level. As of June 2018, CONAMER had completed the MCPAT analysis in all 32 federative entities, identifying a total of 2,417 anticompetitive restrictions. The analysis found numerous regulatory barriers to competition in each state, as well as disparities between states in the number of anticompetitive regulation (Figure 4). When applying the MCPAT methodology, states were most likely to prioritize the commerce, construction, and manufacturing sectors and less likely to prioritize the agriculture, real estate, and tourism sectors (Figure 5).

The integration of the MCPAT analysis into Justicia Cotidiana marks a major shift in Mexico's competition policy and regulatory-improvement agenda. For the first time, a regulatory-improvement program in Mexico was designed and targeted at the effect of reforms on market and competition dynamics. The process engaged subnational public officials and private-sector representatives at the local level in a discussion of competition policy principles and impact of regulations on market contestability. It also revealed unexploited synergies between COFECE and CONAMER to leverage their technical capacity to address anticompetitive regulation. COFECE has now developed several subnational advocacy initiatives focused on removing barriers to competition, and it has increased the number of antitrust investigations in local markets. The two authorities are uniquely positioned to assess and remove potential barriers to competition (Box 1). Mexico is now the first country in Latin America to implement a comprehensive subnational regulatory reform program focused on eliminating barriers to competition.

16 Goverment of Mexico (2015).

Box 1

The institutional authority of COFECE and CONAMER

COFECE and CONAMER have complementary mandates. COFECE is charged with protecting and promoting competition, while CONAMER's primary mandate is to improve the quality of regulation. As poorly designed regulations can inhibit competition, the two institutions have closely aligned objectives, and each can leverage its distinct advantages to address anticompetitive regulations.

COFECE can open administrative proceedings to investigate and officially recommend reforming anticompetitive regulations. It can also use advocacy tools to highlight the negative impact of regulatory barriers on competition and recommend modifications. Moreover, COFECE can investigate and sanction firms and individuals engaging in anticompetitive practices that may be facilitated by restrictive regulations.

At the federal level, CONAMER can review regulatory proposals by conducting regulatory impact assessments. These assessments include an analysis of a proposed regulation's potential impact on competition, which may be informed by COFECE's technical expertise. At the subnational level, CONAMER has developed a deep interinstitutional coordination mechanism with state and municipal authorities to promote better regulation. Under cooperation agreements, CONAMER can advise subnational governments on priority regulatory changes, and it has successfully supported authorities in passing reforms. Annex 1 describes COFECE and CONAMER's complementary mandates and capabilities in greater detail.

In recent years, coordination between the two institutions has increased. CONAMER and COFECE have an institutional cooperation agreement in place to analyze competition effects as part of federal regulatory impact assessments, and CONAMER has created multiple cooperation agreements with subnational governments to improve regulation. CONAMER was also a key counterpart in the initial MCPAT pilot projects in Mexico State and Tabasco. In 2016, COFECE published a compendium of miscellaneous regulatory obstacles to competition at the state level and presented its findings at a National Conference on Regulatory Improvement hosted by CONAMER. Later in the same year, COFECE and CONAMER jointly launched a contest to identify the "most absurd regulatory obstacles," which prominently featured many subnational regulations. In recent years, building on lessons learned, COFECE has focused on its role as a law-enforcement agency tasked with investigating especially distortive local regulatory barriers to competition (such as monopoly rights for trucking associations), and, often in parallel, the anticompetitive practices associated with those barriers (such as trucking cartel agreements). CONAMER, on the other hand, has integrated markets and competition assessments into its regulatory-improvement programs and advocates for widespread reform at the local level.

In the future, CONAMER will further expand its work with subnational authorities. The new General Law on Regulatory Improvement (*Ley General de Mejora Regulatoria*), signed by President Peña Nieto in May 2018, requires CONAMER to publish guideline for a Reform Program for Priority Sectors (*Programa de Reforma a Sectores Prioritarios*) within one year (Art. 11.VII). This reform program will institutionalize the work initiated under *Justicia Cotidiana*, rendering it permanent and sustainable and transforming the MCPAT framework from an individual initiative into an official public policy, similar to longstanding programs such as the System for the Rapid Establishment of Firms (*Sistema de Apertura Rápida de Empresas*), created in 2002.

This report provides CONAMER with a systematic summary of the findings of the MCPAT analysis. It supports CONAMER's overarching strategy for regulatory improvement, as the MCPAT framework has already been embedded in a checklist developed for the *Justicia Cotidiana* initiative, which includes areas such as "governmental efficiency" and "regulatory quality" (Box 2). It can also serve as a guide to institutionalize competition analysis in subnational regulatory impact assessments (RIAs) and in the broader regulatory-improvement

Box 2

The regulatory checklist developed and applied by CONAMER as part of Justicia Cotidiana

With support from the WBG, CONAMER developed a regulatory checklist to support the implementation of its Reform of Three Priority Sectors (*Reforma a Tres Sectores Prioritarios*) project in the context of Justicia Cotidiana. The checklist was designed to complement and expand the use of the MCPAT framework, and it includes four additional considerations for regulatory improvement:

(i) **Facilitating the establishment and operation of firms.** In addition to the MCPAT criteria, this component of the checklist verifies whether the legal instruments adequately protect property rights and promote research and development, innovation, and reinvestment by companies.
(ii) **Governmental efficiency.** This component identifies whether the procedures or information requirements mandated in legal instruments are substantiated by a higher-level legal instrument. It also determines whether public administrative procedures are clear and responsive, easy to understand and impose the minimum necessary compliance costs.
(iii) **Regulatory quality.** This component verifies whether a given legal instrument is aligned with the following principles: a) establishment of rights and obligations; b) regulatory coherence; c) risk-based regulations; d) common language; e) clear objectives; f) clarity on enforcement agencies; and g) easy access to information.
(iv) **Attraction of investment:** This pillar verifies whether a given legal instrument is consistent with attracting investment from non-local agents and aligned with international free-trade agreements.

Source: CONAMER's *Checklist Regulatorio*.

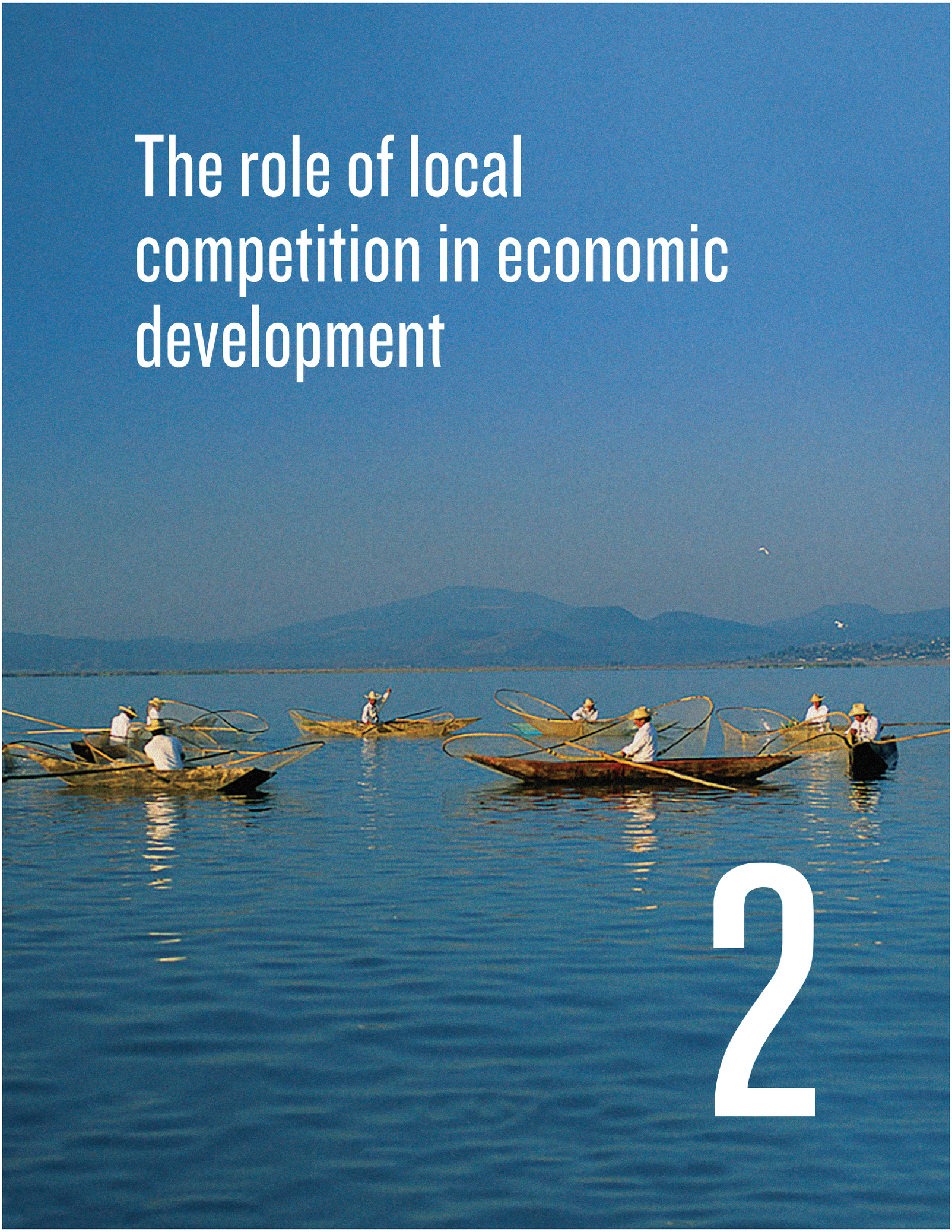
framework. As restrictive regulations are often associated with anticompetitive practices, COFECE's role will continue to be essential in to directly address collusive agreements and other anticompetitive conduct.

This report is divided into five sections. Following this introduction, Section 2 discusses the international experience regarding the role of local competition in economic development. Section 3 briefly presents the MCPAT methodology and its subnational application. Section 4 describes instances of anticompetitive regulation, some of which have been eliminated, and evaluates their harmful effects. Section 5 provides examples of how to design and prioritize reforms based on the interactions between subnational government interventions and the features of local Mexican markets, as well as their feasibility and potential impact.

While the report focuses on Mexico, it also includes valuable lessons from the international experience and has practical applications in a wide range of countries. This report is designed to help countries around the world identify and address anticompetitive regulations, especially countries with a federal structure in which reform opportunities can be pursued by, or in concert with, subnational governments. Efforts to replicate the program described in this report should be tailored to the domestic institutional environment. In Mexico, COFECE has full constitutional autonomy, 287 staff dedicated to competition enforcement,[17] and ample powers to enforce laws against anticompetitive practices and barriers to competition. CONAMER has decades of experience working with state- and municipal-level governments, a network of regulatory-improvement specialists in each jurisdiction, and a reputation for sophisticated engagement with policymakers at every level of government. In addition, CONAMER was assigned 43 dedicated economists, lawyers, and public policy specialists to implement the MCPAT in 32 states. While the institutional and policy framework will vary substantially across countries, the MCPAT methodology allows for flexibility in the scope of its application, including via pilot programs, and it includes political-economy and feasibility considerations that can enable it to succeed in a less mature institutional environment.

17 *Global Competition Review* (2017).

The role of local competition in economic development



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Across countries, regulatory barriers to competition at the national level have been more widely recognized and addressed than have barriers at the local level. International comparative datasets, such as the OECD-WBG Product Market Regulation Indicator, and national regulatory-improvement instruments, such as RIAs, analyze and address regulatory restrictions to competition that national governments have established or may establish. Many countries have not yet systematically assessed the degree to which subnational regulations restrict competition or otherwise distort local markets. While this focus on the national level partly reflects the important role of central governments in setting nationwide norms and standards, evidence from a number of countries reveals that local barriers to competition pose a serious threat to economic growth and development.

Competition authorities in many federal and unitary governments are beginning to address laws and regulations that are issued and/or implemented by local governments tend to reduce competition. Based on the submissions to the annual Global Advocacy Contest, jointly hosted by the WBG and the International Competition Network, competition authorities in at least 10 countries have successfully used advocacy tools to prevent or eliminate barriers to competition at the subnational level. Brazil, France, Kenya, Latvia, Mexico, Panama, Peru, Singapore, Spain, and the United Kingdom have engaged with local authorities to design pro-competition interventions to in sectors such as taxi services, wastewater management, and the hospitality industry.[18]

An analysis of subnational regulations in Peru identified numerous barriers to competition in key sectors. In 2013, 10 of the country's 21 largest municipalities had no procedures in place to authorize the construction of telecommunications systems, limiting firms' ability to compete in the critical area of network expansion. Moreover, 76 percent of complaints filed by businesses cited illegal or unreasonable actions by decentralized governments. The analysis identified over 1,000 bureaucratic barriers that increased the cost of doing business, slowed the expansion of key sectors, and many of these barred competitors from entering a given market or competing on equal terms, with adverse direct and indirect effects on the health of local economies (Table 1).[19]

However, recent reforms in Peru have demonstrated how to successfully utilize a unique international enforcement tool to identify and eliminate illegal or unreasonable barriers to competition.[20] Peru's National Institute for the Defense of Competition and the Protection of Intellectual Property (*Instituto Nacional de Defensa de la Competencia y de la Protección de la Propiedad Intelectual*, INDECOPI) includes a special division authorized to declare that regulatory norms or administrative acts constitute an "illegal or unreasonable bureaucratic barrier" to market entry. This mandate is separate from antitrust enforcement. The unit can also nullify the legal effect of regulations or policy actions

18 For further information on the contest and its "winners", see: http://www.worldbank.org/en/events/2017/11/08/the-2017---2018-competition-advocacy-contest#04, and for a summary of successful advocacy, see: Goodwin & Martinez Licetti (2016).
19 Vostroknutova, Rodriguez, Saavedra, & Panzer (2015).
20 The Peruvian government refers to these as "barriers to market assess and permanence."

Table 1

Regulatory barriers to competition in Peru

	Barrier	Direct Effect	Competition Effect	Indirect Effect
Transport	Minimum capital requirements	Increased cost of doing business	Regulatory protection of incumbents	Poorer service; Higher prices
Telecommunication	Excessive restrictions on installing antennas	Less coverage	Potential barrier to the expansion of more-efficient telecommunications providers	Poorer service; Higher prices; Less access
Construction/ Infrastructure	Various regulatory restrictions and arbitrary actions by local authorities	Less investment; less employment	Potential discrimination against more-efficient infrastructure projects	Less job creation
Retail	Burdensome requirements to obtain operating permits	Increased cost of doing business	Potential discrimination against more-efficient retail stores with greater growth potential	Less job creation

Source: Da Rosa, Licetti, Goodwin, Tan & Jiang (2015), Peru - Tackling regulatory barriers to competition and local economy development, mimeo.

initiated by subnational governments, but its mandate does not extend to laws issued by Peru's Congress. It can impose fines on public officials who do not comply with its directives, and it can initiate constitutional action to expunge regulations it deems a bureaucratic barrier anticompetitive. Reforms in 2015 and 2016 enabled INDECOPI to: (i) ban regulations nationwide, not merely on behalf of the company that filed the complaint; (ii) bar central government authorities from challenging its decisions in court except in very few circumstances, requiring prior approval by the Prime Minister; (iii) rank public entities based on their level of compliance with the elimination of bureaucratic barriers, and (iv) create an electronic portal to publish its resolutions and rankings. These reforms also updated the criteria for declaring a bureaucratic barrier to be illegal or unreasonable, and, for the first time, explicitly included a competition criterion. Following these reforms, the number of illegal bureaucratic barriers voluntary eliminated by government bodies increased from 46 in 2013 to 1,565 in 2016 and reached 3,050 in 2017. Another 701 barriers were sanctioned and eliminated by government bodies in 2017.[21]

In Russia, local governments have also been found to directly support anticompetitive practices. Under Russian law, "anticompetitive actions" by government authorities and representatives can be sanctioned. In 2017, 98.8 percent of infringements on antimonopoly law, both by firms and public authorities, were associated with anticompetitive actions by regional and local authorities.[22]

In Colombia, a lack of competitive neutrality and room for individual discretion in the application of regulations may distort the level playing field. In various sectors, local state-owned enterprises (SOEs) exercise both regulatory and commercial functions while competing with private firms. For example, in 2013 the mayor of Bogota and two local SOEs forced the city's four private waste-management firms to work as SOE subcontractors. At the same time, the municipality created a major regulatory obstacle to market entry by empowering an SOE to authorize or deny access to Bogota's only sanitary landfill. The Colombian Confederation of Chambers of Commerce

21 INDECOPI (2017).

22 From a speech given at the April, 2018 Meeting of the State Council on Promoting Competition. A full transcript is available at: http://en.fas.gov.ru/press-center/news/detail.html?id=52888.

(*Confederación Colombiana de Cámaras de Comercio or Confecámaras*) has determined that the implementation of regulations by local public entities (e.g., police departments, fire departments, and other municipal agencies) in multiple sectors (e.g., security, occupational safety, data protection, urban development) varies substantially across municipalities and regional departments (*departamentos*), undermining regulatory predictability, creating room for discriminatory application, and hindering the expansion of smaller firms. Over 90 percent of the most important business licensing, registration, and regulatory procedures are implemented at the subnational level, 83 percent by local governments and 8 percent by *departamentos*.

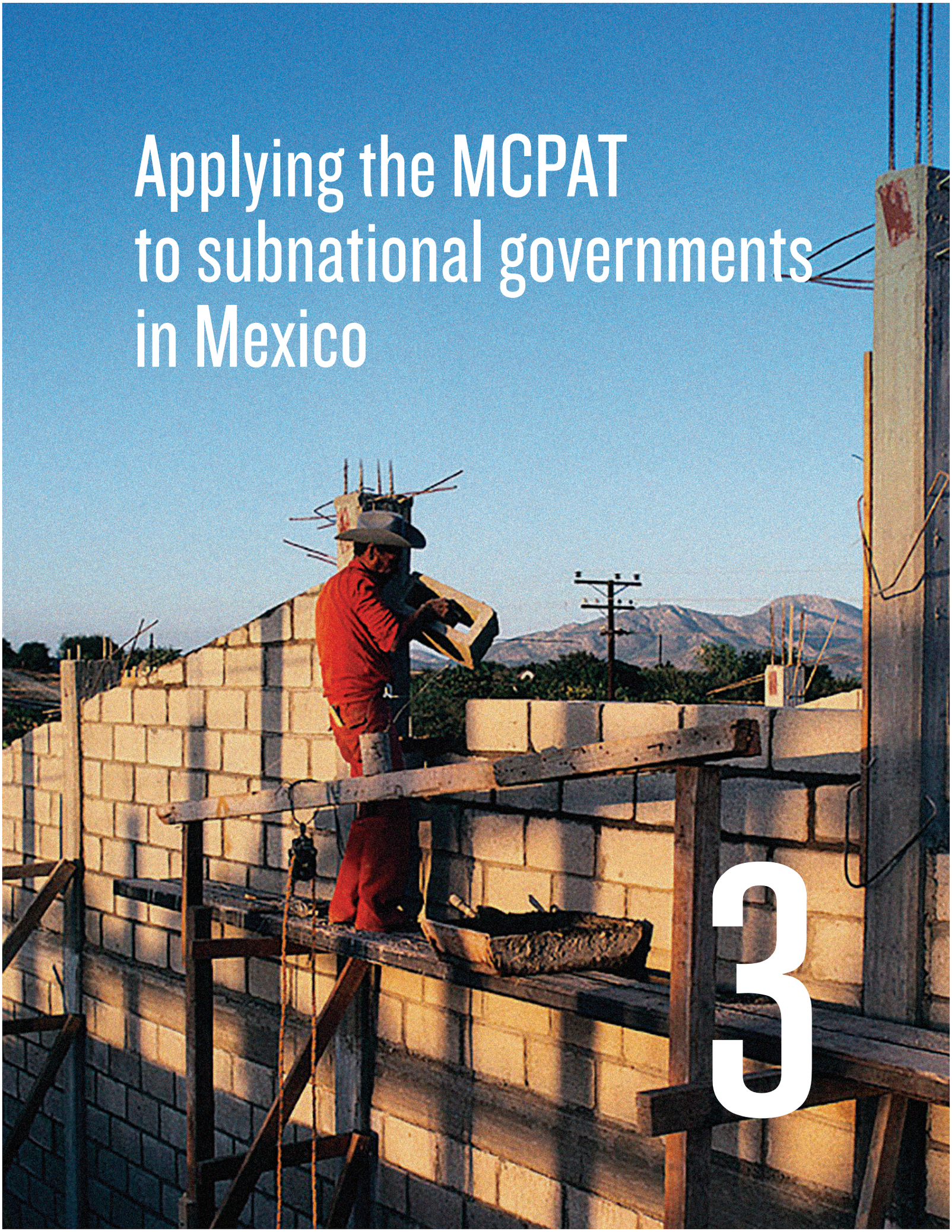
Effective competition at the local level can also be critical to the success of structural reforms at the national level. In Mexico's energy sector, the entry of new private firms competing with the national oil and gas company, Mexican Petroleum (*Petróleos Mexicanos*, PEMEX) may reduce ex-depot gasoline prices. However, subnational regulations often establish minimum distances of more than 1 kilometer between gas stations, reducing the benefit to consumers by granting significant pricing power at the point of sale.

In India, restrictive product market regulations at the state level have inhibited productivity growth. A 2010 OECD study of subnational product-market regulation data from 21 Indian states found that states in which the regulatory environment diminishes economic incentives for firms to compete tend to have lower productivity growth rates than do states in which regulation is more conducive to competition.[23] States with product market regulatory frameworks that are similar to those of developed economies also attract more foreign investment, have a larger share of formal employment, and provide infrastructure more efficiently.

Subnational regulatory changes were at the heart of Australia's National Competition Policy, one of the world's most comprehensive structural reform initiatives, which added an estimated 2.5 percent to Australia's GDP.[24] In 1995, federal and state authorities agreed to implement a plan to systematically remove regulatory barriers to competition and adopt pro-competition reforms. To incentivize action at the state level, the federal government increased budgetary transfers to states that applied competition principles when issuing regulations and that adhered to their commitments under the National Competition Policy.

23 Conway & Herd (2009).
24 Productivity Commission (2005).

Applying the MCPAT to subnational governments in Mexico



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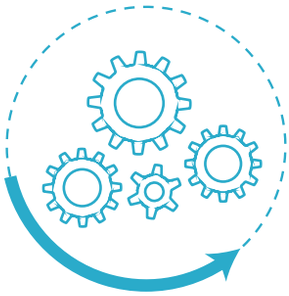


The MCPAT methodology

The MCPAT is designed to help policymakers develop actionable policy options for using competition instruments to improve market outcomes. Unlike other competition assessments, the MCPAT both provides a diagnostic assessment and can guide the prioritization and adoption of pro-competition reforms. The creation of the MCPAT was informed by the WBG's experience advising over 60 client governments on sector-specific policy reforms to promote competition. The MCPAT can be applied to national, subnational, and supranational governments.

The application of the MCPAT at the subnational level must reflect the country's legal and constitutional arrangements. In some countries, subnational governments have the power to issue laws and regulations, and the MCPAT can help identify potential reforms in priority sectors. Among more heavily centralized governments, where local authorities primarily implement laws and regulations issued at the national level, the MCPAT can both promote pro-competition regulatory reform by the central government and assist subnational authorities in improving the efficiency and impartiality of regulatory implementation. In both cases, the MCPAT can help identify which reform opportunities will have the greatest impact at the local level.

Government interventions in the market can be particularly harmful when they exacerbate inherent market characteristics that tend to limit competition, such as natural barriers to entry. The MCPAT provides guidance on how to prioritize regulatory reforms based on the features of the markets they affect. This report analyzes key features of selected markets, especially those that may tend to shape competition, such as product homogeneity, natural barriers to entry, economies of scale and scope, and information asymmetry. It also considers the availability of substitutes and the relative size and integration of the market in Mexico. Based on this analysis, the report identifies regulatory provisions are likely to hinder competition, either by design or through application.

How a given regulation is applied largely determines how much it restricts competition. For example, if a government has the legal authority to limit the number of business licenses, then how many licenses it decides to issue will determine whether its authority imposes a binding constraint on market entry and, if so, how severely it distorts competition. Therefore, the MCPAT assesses both the regulatory framework itself and how public officials implement its provisions in practice.

The MCPAT's subnational application provides a step-by-step approach to identify and prioritize opportunities for reform. The first step is to narrow down the markets or subsectors on which the analysis will focus. The MCPAT prioritizes sectors for analysis that: (i) are highly relevant to the economy, (ii) present indications of limited competition, and (iii) are subject to government interventions that can influence competition. The prioritization process is conducted through desk research, interviews with government regulators and policymakers, interviews with and key current and potential market participants, including firms and business associations, an analysis of available statistics and market information, and a review of relevant laws and regulations.

Figure 6. Subnational application of the MCPAT

Source: Author's elaboration.

Once priority sectors have been identified, market dynamics are analyzed in depth to reveal obstacles to competition. This analysis includes four core elements: (i) market features, including market structure, vertical integration, and direct government participation in the market; (ii) market scenarios, which examine how general market features of a sector play out in the market or state under analysis[25]; (iii) government interventions, including any sector-specific or economy-wide policies and regulations that affect the functioning of sectors being studied; and (iii) market outcomes, which encompass anticompetitive behavior (e.g., abuse of dominance, cartelization, etc.), market concentration, and market entry, inter alia.

Finally, the MCPAT lays the groundwork for policy recommendations. These recommendations reflect the findings of the analysis, as well as the government's

25 While road transportation may have substitutes in some markets or areas, Tabasco has no navigable waterways, and construction material is transported solely by road.

stated policy objectives, and are informed by a review of international best practices. The MCPAT also helps to optimize reform sequencing by estimating the economic damage caused by each regulation, their indirect effects on other economic sectors, and the feasibility of reforming them (Figure 6).

Priority sectors for the subnational MCPAT analysis in Mexico

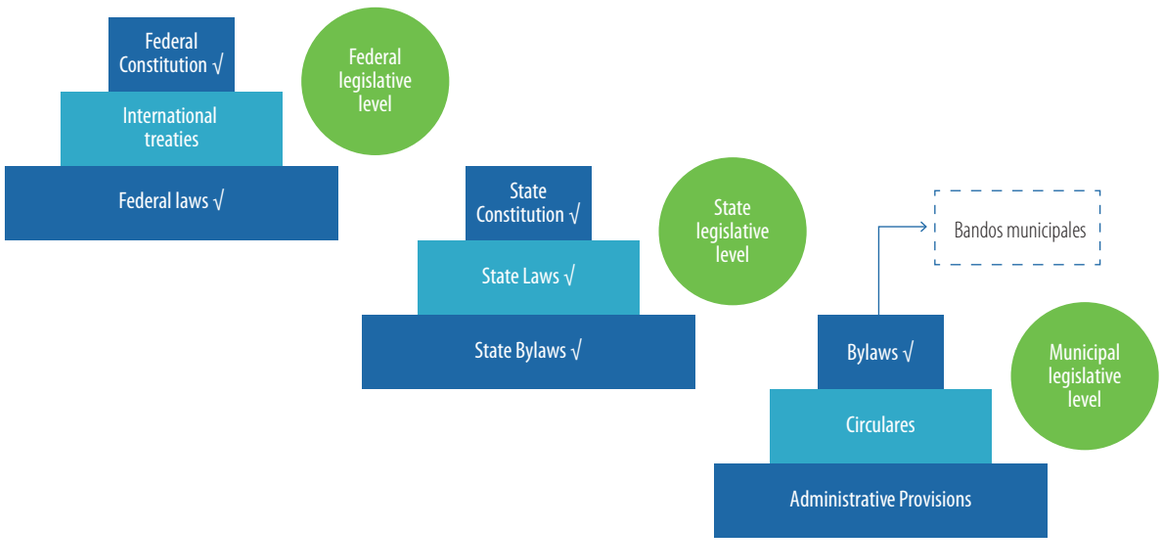
The MCPAT identifies priority sectors for regulatory reform, not for governmental support. The MCPAT prioritization process singles out economic sectors in which competitive distortions are especially damaging and where implementing pro-competition reforms would be both beneficial and feasible. However, this should not be confused with the prioritization of sectors to receive public funds, state aid, promotional support, or other forms of policy assistance.

As in other federal republics, Mexico's central, state, and local authorities are all empowered to issue regulations. The power to regulate a given sector may be shared among these three levels of government (Figure 7). For example, in the transportation sector, the federal government regulates the use of federal roads, while subnational authorities regulate the use of state or local roads. Subnational authorities may derive their mandate to regulate certain sectors via the delegation of powers from the federal government through the federal constitution or federal laws, or via specific state laws or statutes.

Subnational authorities can use two nonexclusive methods to affect economic activity, the first of which is to directly regulate a certain aspect or aspects of a given market. The major elements of direct or *substantive* regulation include: (i) establishing requirements to enter a given market and provide services or produce goods, (ii) setting rules for how firms in a given market must behave, (iii) determining or influencing prices and/or determining access conditions for the services or goods produced in a given market; (iv) defining how business associations are constituted and conditioning their participation in a given market; and (v) and other forms of regulation that affect how a given market operates.

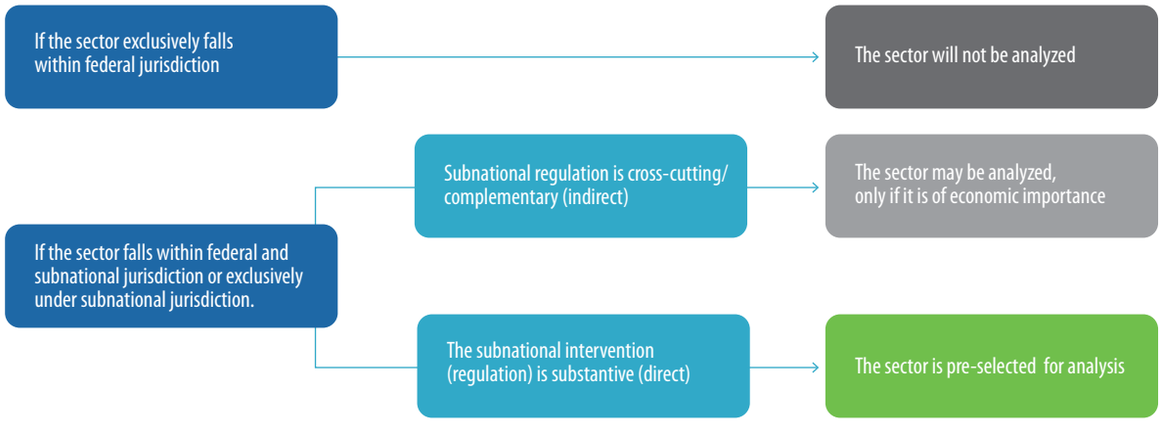
The second method is to regulate other activities that indirectly affect aspects of the market. Complementary or indirect regulation obliquely influences market conditions without direct government

Figure 7. The hierarchy of Mexican legal instruments



Source: CONAMER. Note: Legal instruments with a checkmark were prioritized for the MCPAT analysis.

Figure 8. Sector-selection criterion: administrative jurisdiction



Source: Author's elaboration.

Table 2

The regulatory mandates of state and municipal authorities in Mexico

Sector Name	State purview	Municipal purview
Agriculture, animal breeding and production, forestry, fishing and hunting	X	
Mining		
Electric power generation, transmission and distribution, water and gas supply through mains to final consumers	X	
Construction	X	X
Manufacturing	X	X
Wholesale trade	X	X
Retail trade	X	X
Transportation, postal services and warehousing	X	
Mass media information		
Financial and insurance services		
Business support services, waste management and remediation services	X	X
Real estate services, tangible and intangible goods, rental and leasing	X	X
Educational services	X	
Health care and social assistance services	X	
Temporary accommodation services and food and beverage preparation services	X	X
Other services, except government activities		
PPPs	X	
Economic Development	X	
Public Procurement	X	X

Source: CONAMER. Note: This industry classification is based on the *Sistema de Clasificación Industrial de América del Norte* 2013 and includes three cross-cutting segments of the economy: public-private partnerships, economic development and public procurement.

Box 3

Subnational regulation in unitary governments: A case study from Peru

In unitary governments, economic regulation typically flows from laws passed by the national legislature and statutes issued by line ministries. However, some substantive regulatory matters are delegated to subnational governments, and subnational authorities are frequently tasked with implementing central-government policies.

Peru has three levels of government: the national government, 25 regional governments, and more than 1,600 municipal and district governments. The Peruvian legal framework empowers these different levels of the government to issue regulations that affect investment projects in key sectors such as telecommunications, transportation, energy, mining, and retail, which are critical to local economies. While in most cases a national or regional government must authorize the investment project, in every case the actual project permits must be obtained from a local government. In addition, agencies with cross-cutting mandates, such as environmental protection or water management, are required to authorize all investment projects in key infrastructure sectors. Consequently, approval for an investment project must be granted by multiple levels of government.

Sector	**Government level**		
	National	**Regional**	**Local**
Sanitation	Yes	No	Yes
Energy and mining	Yes	Yes	Yes
Transportation	Yes	Yes	Yes
Telecommunications	Yes	Yes	Yes

A WBG assessments of the Peruvian legal framework showed that a lack of coordination and limited technical training of regional and local authorities by the central government hindered the implementation of reforms designed to simplify regulatory processes. The assessment also found that most obstacles to the development of key projects, including delays and illegal and or irrational requirements, were imposed by local authorities, which issued acts or regulations that contradicted national policies and which failed to implement regulatory reform policies at the local level.

Even in a unitary government, subnational authorities may have considerable latitude to distort competition in local markets. In these cases, a subnational MCPAT tailored to reflect the role of regional and local authorities in a unitary system can reveal important barriers to competition.

intervention. For example, in some cases subnational governments may issue public safety or environmental policies that do not directly apply to a given market but that nonetheless affect its competitive dynamics, especially when these policies apply differently to various competitors in the same market.

The subnational application of the MCPAT in Mexico focused on assessing substantive regulation. While evaluating indirect or complementary regulation may be appropriate in some circumstances, Mexico's most distortive interventions appear to occur through substantive regulation. As the analysis was designed to examine subnational regulation, it focuses exclusively on sectors that are subject to direct or at least indirect regulation by either state or municipal authorities (Figure 8 and Table 2).

The subnational MCPAT methodology can be applied to both federal systems and unitary governments.

Figure 9. Sector-selection criterion: regulatory nature and impact

Source: Author's elaboration.

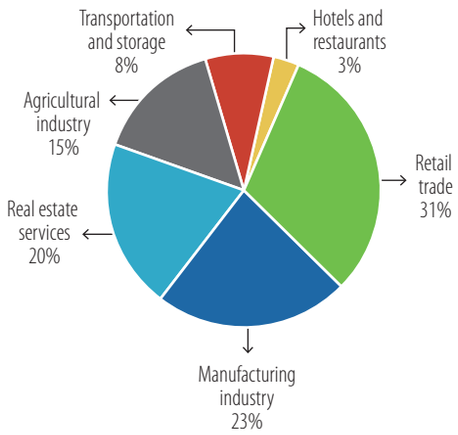
Even in countries where subnational authorities have limited legislative and regulatory autonomy, a subnational MCPAT could identify distortions in local markets caused by the uneven implementation of laws and regulations issued by the central government (Box 3).

Direct regulatory interventions are typically grounded in either economic or social policy objectives. Economic regulation is often designed to cope with market failures—for example, by simulating competitive outcomes in a natural monopoly. Social regulation frequently aims to correct information asymmetries between individuals and firms, or to compensate for externalities and spillover effects. In addition, administrative regulation includes procedures and formalities through which governments collect information and can intervene in economic decisions. While the MCPAT can evaluate both economic, social and administrative regulation, some social and administrative regulations may be omitted from the analysis if they are unlikely to significantly impact market competition, such as traffic rules, building codes, or environmental standards (Figure 9).

As noted above, sectors are selected based on their contribution to the local economy and indicators of lack of competition. In Mexico, the subnational MCPAT identified economically relevant sectors that showed signs of competitive distortion through a three-step process. First, sectors were evaluated based on their contribution to economic output, productivity, and investment, as well as their contribution to major supply chains, spillover effects on other sectors, share of consumer spending, and impact on poor households. Second, once economically vital sectors had been identified, subsectors were selected based on their relevance to the local economy and the extent to which they were under the regulatory purview of subnational authorities. Third, the range of subsectors was narrowed to those that showed preliminary signs of market failures or lack of competition. These subsectors exhibited potential or actual anticompetitive practices, possessed economic characteristics that generally indicate succeptibility to market concentration or collusion, or presented evidence of significant market deficiencies, such as low levels of productivity, an insufficient or excessive number of firms, unusually high prices, and poor product or service quality, inter alia.

In the State of Michoacán, retail and manufacturing were identified as priority sectors for analysis. Six sectors contribute substantially to Michoacán's total economic output (Figure 10). Over the last five years, retail grew by 10 percent—a faster rate than any other sector and well above Mexico's average retail-sector

Figure 10. Economic output in Michoacán by sector



Source: INEGI.

growth rate of 6 percent. About 30 percent of workers in Michoacán are employed in retail. The manufacturing industry is the second-largest contributor to the state's economic output at 16 percent, and it employs 12 percent of the state workforce.

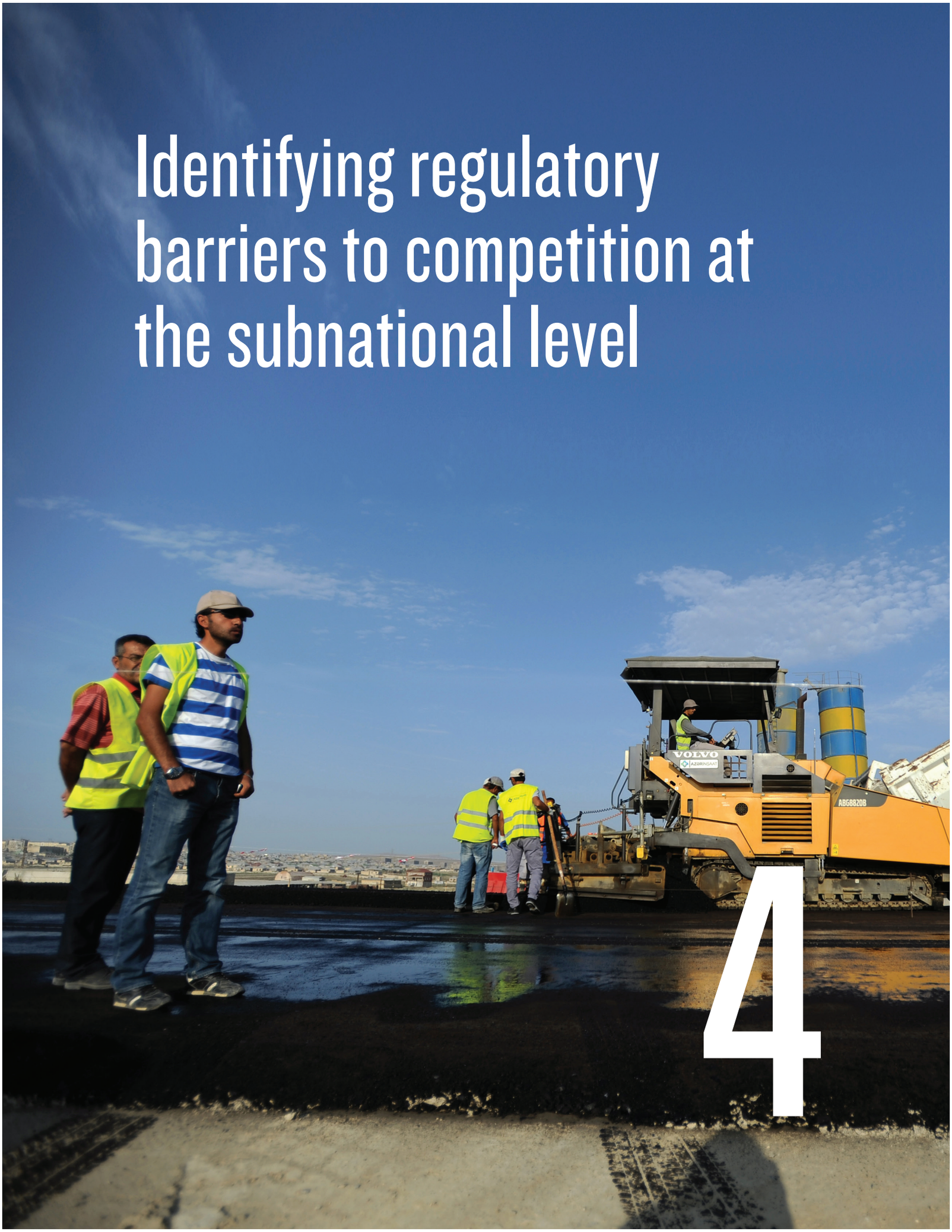
Among Michoacán's retail subsectors, supermarkets and grocery stores are both highly relevant to the local economy and subject to direct regulation by state and local authorities. In Mexico, municipalities are empowered to regulate the commercial sale of food. Moreover, grocery stores and supermarkets have particularly levels of high value added, and 7 percent of Michoacán's workers are employed in this subsector.

Regulations in the supermarkets and grocery stores subsector may adversely affect competition and lead to suboptimal market outcomes. Overall, productivity of supermarkets and grocery stores in Michoacán is an estimated 24 percent lower than comparable facilities elsewhere in Mexico. Competitors have difficulty entering some markets in the food value chain. For example, the municipalities of Morelia and Lázaro Cárdenas have only one and two slaughterhouses, respectively, and these facilities lack the capacity to satisfy local demand. In Lazaro Cardenas, municipal regulations explicitly prohibit the commercial sale of meat that does not come from slaughterhouses that are located in Lazaro Cardenas and that have been inspected by the municipal authorities.

Across Michoacán, the regulation of tortilla production is particularly relevant to local economies. In Mexico, municipalities have the legal authority to impose rules on the establishment and operation of tortilla venders. Tortilla production account for a full 14 percent of jobs in the manufacturing sector, including 10 percent of manufacturing jobs in Michoacán.

Regulations on tortilla production and sale appear to negatively affect competition. A preliminary assessment revealed evidence of price-fixing schemes within municipalities and among producer groups. In 2016, the Dough and Tortilla Industry Association (*Asociación de la Industria de la Masa y la Tortilla*) in Lázaro Cárdenas announced a fixed price for one kilo of tortilla of 19 Mexican pesos (MXN). This fixed price was MXN 5.8 higher than the average price in Michoacán and the surrounding states of Colima, Guadalajara, and Nayarit and MXN 6.6 higher than the average for the nearby municipality of Morelia.

Identifying regulatory barriers to competition at the subnational level



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In Mexico, subnational regulations are typically issued through general laws approved by State Congresses, along with their implementing bylaws. These bylaws provide additional specifications for the regulation of a given sector. Although each state is constitutionally independent and follows its own procedures, the general laws share common features, especially with respect to their main provisions. An analysis of potential barriers to competition should begin by examining the key provisions of the general regime, then consider its implementing bylaws or other complementary regulations. A standard set of research questions can reveal which laws and bylaws are most likely to adversely affect competition (Figure 11).

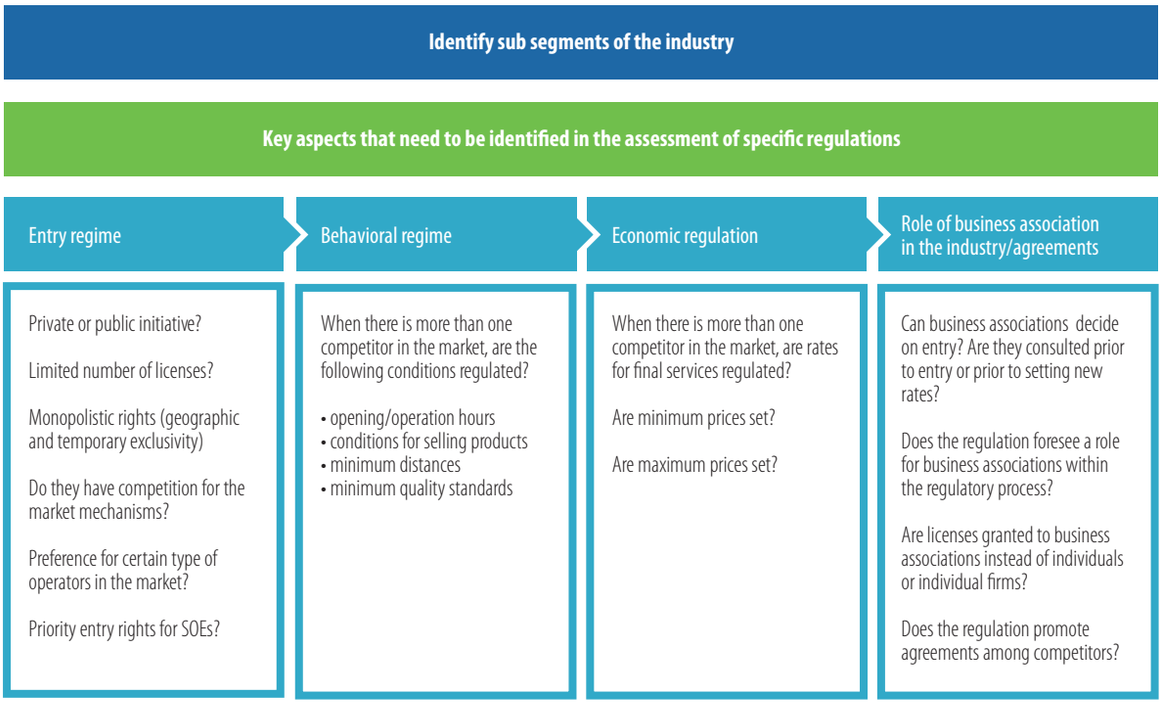
Per the MCPAT methodology, potential regulatory barriers to competition can be classified into three main groups according to their effects. These three categories are: (i) rules that reinforce market dominance or limit entry; (ii) rules that are conducive to collusive outcomes or increase the costs of competing in the market; and (iii) rules that discriminate between firms and protect vested interests. These types of policies include, but are not limited to, restrictions on the number of firms that can enter the market, regulations that control or directly affect market variables such as the price or quantity of goods and services, and regulations that tend to favor inefficient firms.

The MCPAT identifies anticompetitive regulations according to a specific typology, with examples for each type. The subnational MCPAT in Mexico identified common government interventions that can impact competition in local markets based on the team's extensive experience in assessing Mexico's regulatory framework and government interventions. Whereas in unitary governments the scope for interventions by subnational authorities is relatively limited, the Mexican federal system vests subnational authorities with significant independent powers. Consequently, subnational authorities in Mexico can intervene in local markets both by issuing regulations and by directly participation in the market through public enterprises, state-aid programs, fiscal incentives, and public procurement.

The MCPAT classifies regulatory provisions according to their impact on the market (Figure 12). Regulations can affect competition both directly and indirectly. For example, a regulation that directly constitutes a barrier to entry may also indirectly facilitate collusion between incumbent firms. In cases where a regulation may create more than one type of competition restriction, the analysis should distinguish between its primary and secondary effects, and prioritize the former. For example, a limit on the number of business licenses may directly impeded market entry, and it may indirectly facilitate collusion by limiting the number of firms operating in the market. In this case, the analysis should focus on the primary effect.

While all Mexican states impose restrictive regulations, the most common type of regulatory barrier varies from state to state. As part of the subnational MCPAT, an analysis conducted by CONAMER revealed wide regional differences in the number of anticompetitive regulations, as well as important variations in their nature and effect. Nuevo León has adopted 72 rules that reinforce dominance and limit entry (Figure 14), while Baja California Sur has more rules

Figure 11. Standard questions to identify regulations potentially harmful to competition



Source: Author's elaboration. Note: This list presents a basic set of questions that are applicable in most circumstances, but it should not be regarded as exhaustive. Additional questions should be tailored to the local legal and regulatory context.

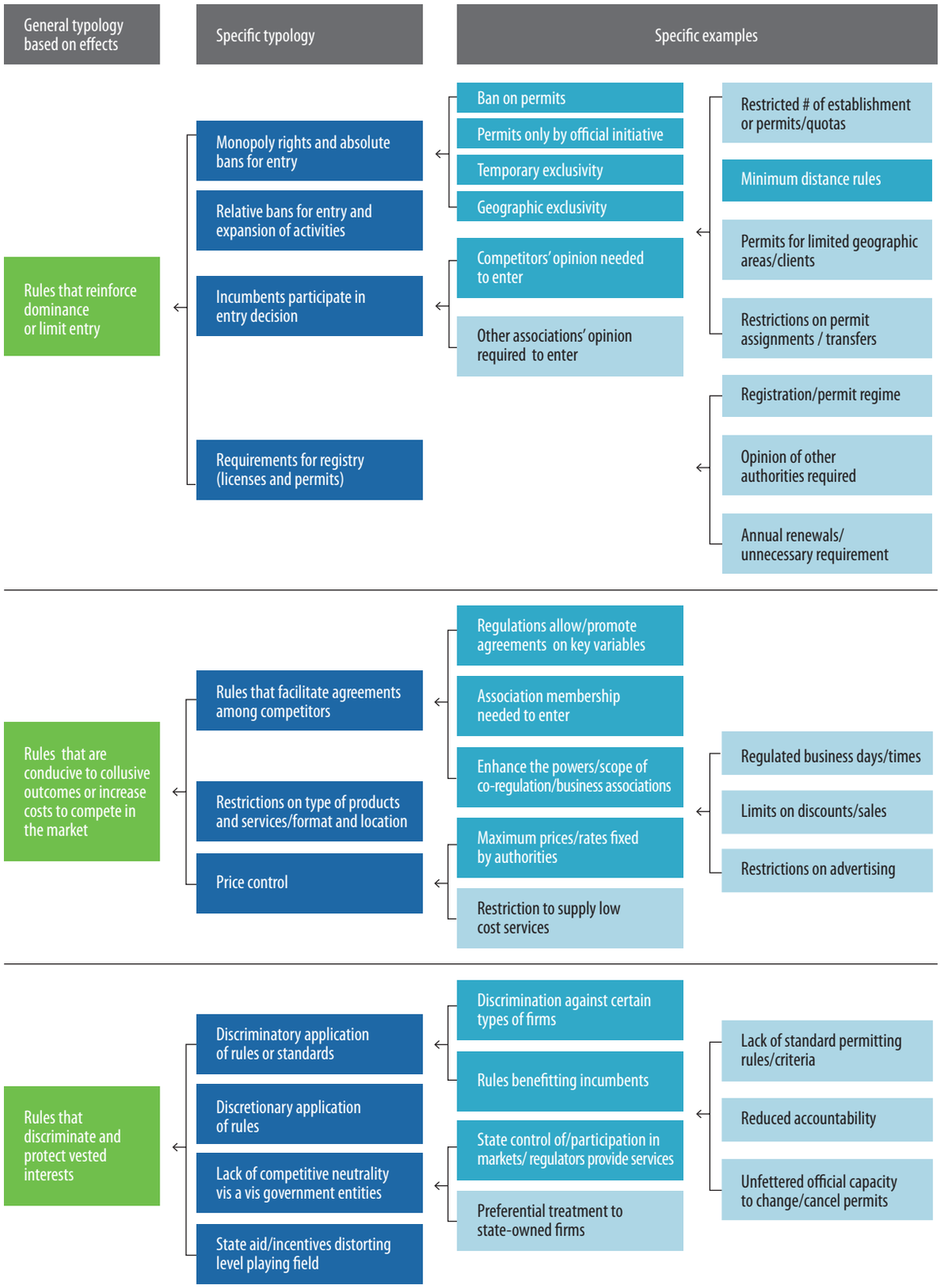
that are conductive to collusive outcomes or increase the costs of competing in the market (Figure 15), and Hidalgo has more rules that discriminate and protect vested interests (Figure 16). An analysis of selected WBG-led projects in Oaxaca, Tabasco, and the State of Mexico highlighted further differences in the degree to which these regulations restricted competition (Annex II).

A simple correlation analysis indicates a potential link between the number of regulatory barriers and multiple firm dynamics. The analysis found that the number of regulatory barriers identified in the context of *Justicia Cotidiana* was associated with the average growth rate of the number of firms[26] (Figure 17) and the net growth of sales by firm (Figure 18) between 2009 and 2014.[27] This may indicate that a larger number of regulatory barriers is more likely to include a binding constraint on firm entry and expansion, that the challenge of complying with numerous distortive regulations is itself an obstacle to competition, that a large number of regulatory barriers indicates the presence of powerful vested interests, or some combination thereof. Further empirical analysis could shed greater light on the relationship between the number of regulatory barriers and firm dynamics and market variables.

The following section describes each category of anticompetitive regulation and provides specific examples of government interventions at the subnational level in Mexico. The examples deliberately focus on markets in which competition is viable, as opposed to natural monopolies. While regulation is

26 INEGI defines these as "economic units."
27 Even though these regulatory barriers were identified between 2015 and 2018, it can safely be assumed that almost all of them were already in place between 2009 and 2014.

Figure 12. A typology of regulations based on their market effects



Source: MCAPT. Note: The specific examples of regulatory restrictions in dark blue are generally considered more restrictive to competition than those in light blue.

Figure 13. The number of regulatory restrictions identified in key sectors

Figure 14. The number of rules that reinforce market dominance or limit entry

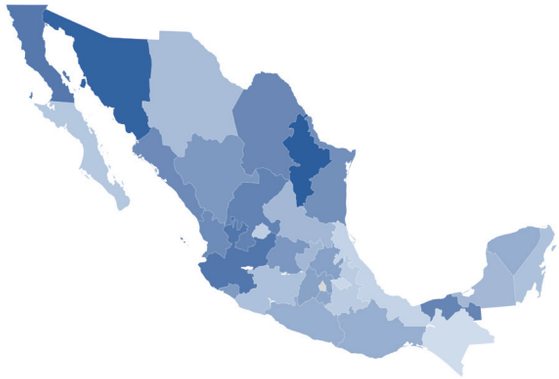


Figure 15. The number of rules that are conducive to collusive outcomes or increase the costs of competing in the market

Figure 16. The number of rules that discriminate and protect vested interests

Source: CONAMER, MCPAT application under Justicia Cotidiana. Note: The number of regulatory restrictions was weighted by the number of sectors covered in each state (usually 3, and in some cases fewer), in order to make the map comparable. In one state, up to 165 restrictions were found across 3 sectors. Darker shades of blue reflect a higher number of regulatory restrictions to competition. These figures therefore represent the minimum number of potential regulatory restrictions to competition that may exist in each state.

often justified and even necessary in order to ensure efficient market outcomes, subnational governments in Mexico frequently employ economic regulation in cases where market characteristics do not warrant it. Such regulations can be eliminated, or replaced with simple ex post monitoring mechanisms to enforce minimum standards, without the need to establish alternative regulations.

Rules that reinforce dominance or limit market entry

Competitive markets are characterized by the ability of new firms to enter the market and the ability of existing firms to expand or exit. Indeed, the potential for competitors to enter, even if no competitors actually do so, may suffice to discipline incumbent firms and

Figure 17. The average growth rate of the number of firms (2009-2014), and number of regulatory barriers identified

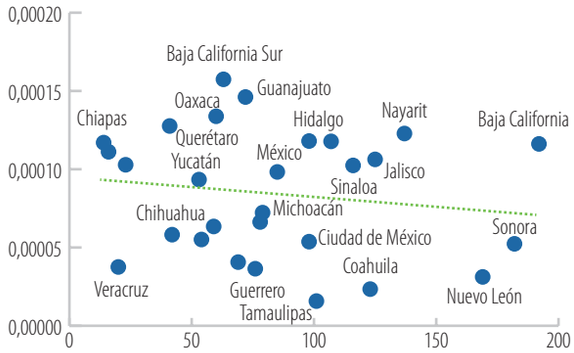
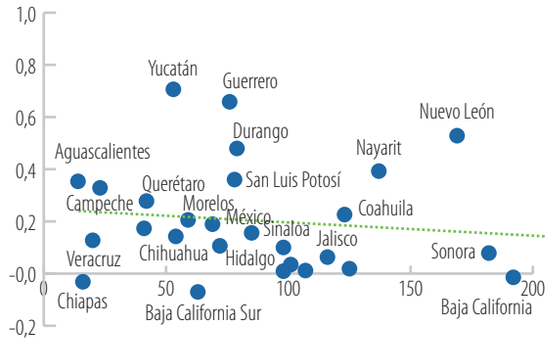


Figure 18. The average firm-level net sales growth rate (2009-2014), and the number of regulatory barriers identified



Source: CONAMER analysis, based on data from INEGI. Growth in the number of economic units is the average across sectors and weighted by sector-relevance in terms of total number of firms, per state. Note that the total number of regulatory barriers include some additional regulatory barriers identified, beyond those associated with the categories of MCPAT. For comparison purposes, states in which less than 3 sectors were analyzed have been excluded from this analysis.

prevent powerful incumbents from raising prices above competitive levels. For example, incumbent airlines have been found to reduce airfares on a given route by at least 17 percent when faced with the threat that a competing airline will begin serving that route.[28]

Unnecessary barriers to business entry and expansion can promote market concentration or preserve the dominance of incumbent firms. Such barriers can reduce consumer choice and create artificial scarcity that increases prices. Restrictive regulations may indicate rent-seeking by powerful economic interests. By influencing the regulatory policy and enforcement processes, incumbent firms can artificially generate barriers to discourage the entry of new investors and protect their privileged position. Incumbent firms are likely to exercise their market power and implement collusive agreements in concentrated markets with high barriers to entry. Beyond simply preventing new competitors from entering the market, these barriers may delay the entry of competitors or force them to enter the market at a smaller scale, with a reduced range of products, or with a less attractive commercial proposition.

While barriers to entry can be grouped into three categories—legal or regulatory, structural,[29] and strategic[30]—the following analysis focuses exclusively on legal or regulatory barriers. Legal or regulatory barriers to entry can stem from any form of public intervention in the market. According to the MCPAT methodology, regulations that constitute barriers to entry include: (i) rules that create monopolistic rights or impose an absolute ban on the entry of new firms; (ii) rules that impose a relative ban on the entry of new firms or inhibit the expansion of business activities; (iii) rules that allow incumbents to participate in market-entry decisions; and, (iv) rules that create excessively burdensome licensing and registration requirements.

28 Goolsbee and Syverson (2008).

29 Structural barriers are created by the technological conditions of the market. They include large initial capital requirements, high transportation costs, economies of scale and scope, large sunk costs, vertical integration, and cultural differences. Furthermore, the presence of network effects or externalities may create a natural monopoly and constitute a barrier to entry.

30 Strategic barriers to entry are created through the deliberate actions of incumbent firms. Some strategic barriers are legitimate business behaviors that have a limited impact on competition and ultimately increase consumer welfare, such as investments in research and development and patent filing. However, exclusive contracts with distributors, the refusal to supply an essential input, and predatory pricing are examples of strategic barriers to entry that often result in an anticompetitive conduct.

Rules that create monopolistic rights or impose absolute barriers to entry

Absolute barriers to entry explicitly entrench the dominant position of an incumbent firm or firms. Regulations that create monopolistic rights severely and unambiguously reduce competition by directly preventing new firms from challenging incumbents, effectively establishing private or public monopolies or oligopolies in specific markets. While absolute barriers to entry may be justified in a narrow range of cases—for example, the regulation of natural monopolies or the allocation of rights to scarce natural resources—they should not be applied to markets that would otherwise be competitive.

Regulations that create monopolistic rights or bar the entry of new firms are among the most harmful, and the most common, anticompetitive regulations in Mexico. The subnational MCPAT revealed 69 subnational regulations that constituted absolute barriers to entry. In Mexico State, Tabasco, and Oaxaca, the WBG prioritized seven reforms to address these restrictions, which the MCPAT found to be most common in transportation and retail sectors nationwide. Examples of absolute barriers to entry in Oaxaca highlight their distortive impact.

In Oaxaca, the state government banned all transportation concessions for a two-year period. Under the state laws that prevailed when the assessment was conducted, all passenger and cargo transportation firms were required to obtain a concession to offer services anywhere in Oaxaca. In principle, such concessions were supposed to be granted only if the service was deemed viable and necessary to meet demand. In practice, however, there was no standard procedure to assign routes, and the authorities had detected close to 14,000 irregularly granted concessions. Some passenger routes were congested, while others had excess capacity. The state government responded by passing an absolute ban (*veda*) on new concessions for two years.

Contrary to the policy's intent, barring the entry of new transportation firms increased informality and failed to reduce congestion. Adopting an absolute barrier to entry set an adverse precedent regarding the use of discretionary authority to protect incumbent firms, and it did not address the deficiencies in the regulatory framework that created the problem. Indeed, the irrational granting of concessions itself stemmed from the excessive discretionary power of public agencies to grant those concessions. As these discretionary powers remained unchanged, the ban compounded the underlying problem instead of addressing it.

In addition, the municipal government of the state capital, Oaxaca de Juárez, imposed bans on certain retailers. During the last year of its mandate, the municipal government barred the granting of new licenses for restaurants, bars, and other businesses that serve or sell liquor. It also imposed a de facto ban on any new permits for street vendors. These measures were meant to address social problems, including corruption and informality. However, other regulatory measures could have achieved the same objectives with a less-negative impact on competition, such as reducing discretionary administrative powers, increasing transparency, and strengthening regulatory supervision and enforcement mechanisms.

Rules that create a relative barrier to entry or inhibit the expansion of activities

Less stringent than an absolute ban on entry, marginal or relative restrictions seek to maintain the current market structure by limiting the number of competitors or the range of activities they can engage in. These rules are usually justified by the claim that a market is saturated and cannot sustain additional businesses. However, a regulation that prevents firms from entering a saturated market contradicts its own premise: if the market were truly saturated, new firms would be unable to gain adequate market share to survive, and regulations impeding their entry would be unnecessary. Instead, marginal restrictions hinder legitimate competition by limiting access to input or distribution channels, or by establishing minimum distances between outlets or processing facilities. Examples of this kind of regulation include quotas on the

number of permits issued for certain types of business or the number issued to a single firm, the granting of licenses for limited geographic areas or clients, and restrictions on transferring permits.

Marginal barriers to entry or expansion are common in Mexico. The subnational MCPAT revealed 421 relative barriers to entry, most of which were in the retail sector. In Mexico State, Tabasco and Oaxaca, the WBG prioritized four reforms to address these restrictions. Examples of relative barriers to entry in Oaxaca and Culiacán underscore their adverse effects on competition.

The municipal government of Oaxaca de Juárez issued regulations restricting licenses for retail firms and investments. The regulations limited the number of licenses for outlets in public markets and pedestrian areas that can be awarded to any individual competitor, thereby constraining the expansion of successful retailers. The municipality also established a minimum distance between businesses that sell or serve alcoholic beverages. Making it more difficult for consumers to comparison shop across establishments located several hundred meters apart created local market power for incumbents and effectively limited consumer choice. Though restricting the ability of firms to sell alcohol in the vicinity of schools, hospitals, churches or sports fields may have valid public-policy objectives, establishing a minimum distance between business that sell alcohol meaningfully restricts competition.

The Culiacán municipal government similarly, and even less justifiably, established minimum-distance regulations to limit competition among gas stations and tortilla stores.[31] The minimum distance between gas stations varied from 450 meters to 10 kilometers, while the minimum distance between tortilla stores was fixed at 400 meters. To obtain an operating permit, store owners were forced to sign a written commitment not to conduct business activities less than the minimum distance from their competitors.

COFECE has actively promoted the elimination of rules mandating minimum distances between gas stations, especially in the wake of the federal energy reform. In 2012, COFECE issued an opinion on the impact of these rules on competition and determined that undefined "security reasons" were an insufficient justification. COFECE ruled that these types of restrictions prevented markets from functioning efficiently by protecting existing businesses from actual and potential competitors and by preventing the market forces from determining the optimal number and distribution of businesses. In 2017, the State of Sinaloa eliminated minimum distances between gas stations, which had been up to 5 kilometers.[32] The same year, COFECE formally challenged the constitutionality of minimum distances before the Supreme Court, referring to a case in the State of Coahuila, which had established minimum distances of between 500 meters and 10 kilometers between gas stations.[33] In its arguments, COFECE has often referred to the importance of competition among gasoline retailers to ensure that the benefits of opening the energy markets are passed on to consumers.

Geographic restrictions on tortilla stores remain common in Mexico. COFECE has also repeatedly issued opinions detailing how minimum distances between tortilla stores limit competition, including in Tapachula (Chiapas), Tuxtla-Gutiérrez (Chiapas) and Salina Cruz (Oaxaca). As early as 2010, the Office of the Federal Prosecutor for the Consumer (*Procuraduría Federal del Consumidor*, PROFECO) had highlighted the frequency of restrictive regulations in this market and their adverse impact on household consumption.[34]

Across Mexico, regulations on notaries commonly restrict the entry of new professionals and their ability to expand their services. In 31 out of 32 federative entities, notary associations are tasked with supervising the implementation of state laws regulating notary services. These laws often hinder competition by directly restricting the number of notaries. In 18 federative entities, the number of notaries is limited by the number

31 Municipality of Culiacán (2007) as reported in COFECE (2012), Municipality of Culiacán (2004).
32 *Noroeste* (2017).
33 *El Sol de Mexico* (2017).
34 García & García Soto (2010).

of inhabitants per municipality or judicial district. In some cases, the number of notaries is capped at one per 50,000 inhabitants. According to COFECE, tighter limits are linked with higher fees for notary services, but not necessarily with higher service quality.[35] Notary service state laws also frequently allow for discretion in licensing notaries. In most federative entities, the executive branch can grant licenses "when in its judgment, the increase in business activity requires it" or "taking into account the needs of the notary service itself."[36] These criteria are not objective. They generate uncertainty for potential new notaries and do not promote service quality. Some notary service state laws establish requirements that are not justified by a public-policy objective. In 26 federative entities, some requirements are highly subjective and lack any clear relationship to notarial functions. These include "good conduct," "an honest way of living," "an honorable reputation," and "good morals."[37] Additionally, 28 federative entities establish a minimum age for notaries, which ranges from 25 to 33 years old.

Rules that allow incumbents to influence decisions as to which firms can enter the market

Rules that allow incumbents to influence decisions regarding the entry of new firms can enhance their market power. Some jurisdictions give professional associations the legal right to decide whether new suppliers are eligible to provide a service. These regulations are based on the premise that only a limited number of firms can operate effectively in a given market. Under them, policymakers may grant existing suppliers the right to veto a new entrant, protecting them from competitive pressure at the expense of the interests of consumers.

These restrictions are relatively uncommon, but particularly harmful to competition. The subnational MCPAT revealed 90 instances of incumbents participating in entry decisions, most often in the transportation and agribusiness sectors. In the case of Mexico State, Tabasco, and Oaxaca, the WBG prioritized two reforms to address this type of rule. Examples of incumbents participating in entry decisions in Sonora and Chiapas highlight the impact they can have on local markets.

Sonoran state law allows incumbents to influence decisions regarding the entry of new commercial livestock producers. The state's Livestock Law requires that any individual or company that raises or markets livestock, animal products, or animal byproducts must obtain formal authorization to enter and leave Sonora. Requests for authorization must be submitted to the livestock union or the state Livestock Secretariat. The union or the secretariat can then issue an opinion as to whether the requesting party should be granted authorization. This regulation enables incumbents to influence which firms and individuals are able to access the Sonoran livestock market.[38] The law specifically states that the authorizing entity should take into account the union's opinion and ensure that the entry of new participants does not affect existing producers or disrupt the state's supply of livestock and related products. Granting incumbents the power to limit participation of competitors tends to restrict competition.

The city of Berriozabal in the State of Chiapas allows existing firms to veto the entry of new tortilla producers. The regulations of both the State of Chiapas and the city of Berriozabal allow existing tortilla producers to participate in the decision to allow new firms to enter the market.[39] By law, three current

35 COFECE (2017).
36 Ibid.
37 Ibid.
38 Article 86 of the Livestock Law for the State of Sonora states: "For the introduction or departure of the State of livestock, its products and by-products, must have the authorization previously issued by the Secretariat and, in addition, the mobilization must be covered with the transit guide issued by the inspector of livestock and with the corresponding health documentation. The respective requests must be made through the Regional Livestock Union of Sonora, who will express its opinion on the matter". Article 67 of the same law states: "For the issuance of authorizations mentioned in Article 86, the Secretariat, in case of livestock products and by-products, must take into consideration, in advance, the opinion of the corresponding cooperation agencies, as well as the needs of the population, so that the producers and the supply of products for the State population are not affected."
39 Article 13 states that: "For the regulation of opening of establishments and distribution of tortilla dough and tortillas, a Technical Advisory Committee will be created, which will be integrated by the Municipal President, who will be the President of the Technical

tortilla producers must form a Technical Advisory Committee, which has the power to "issue an opinion on the opening and operation of the tortilla shops, as well as any irregularities or controversies that may arise regarding the requests for operating permits."

Rules that create excessively burdensome licensing and registration requirements

Even regulations that do not directly restrict market entry can increase the administrative cost to new entrants. Some of these rules apply to market entrants themselves—for example, by requiring that would-be service providers obtain membership in a professional organization. Other rules impose restrictions on specific goods or services—for example, by requiring the costly testing and registration of crop varieties.

Licenses, permits, or other authorization regimes that impose disproportionate requirements on new entrants can restrict competition. While the nature of some markets justifies the imposition of minimum standards on market participants, authorization regimes can also unnecessarily increase costs and discourage the entry of new competitors. Onerous compliance processes and requirements that licenses be renewed frequently raise the administrative burden of establishing a new business, particularly when the authorities pass the cost of verifying compliance on to businesses in the form of licensing fees.

License and permit rules that require multiple authorizations from different local authorities can further limit market access. These rules are often based on the reasonable premise that granting new licenses for a certain activity may adversely affect the interests of other sectors and/or conflict with larger policy objectives. However, by prioritizing ex ante controls, this type of regulation deters new market entrants and empowers incumbents. Ex post evaluations are better suited to determine whether an activity has a negative impact on the public interest, especially since a business that initially meets the necessary criteria to obtain the permit may not continue to do so over time.

Authorization regimes are particularly common in Mexico. The subnational MCPAT revealed 390 cases of unnecessary or excessively burdensome license and permit requirements. However, the harm these rules cause to market dynamics depends on both the specific features of each market and how the rules are implemented. Consequently, authorization regimes are not always a priority for reform. In the case of Mexico State, Tabasco, and Oaxaca, the WBG prioritized one reform to address unnecessary license and permit requirements. Examples of excessively burdensome authorization regimes in the State of Nuevo León underscore their impact on local markets.

Transportation providers need separate permits to travel through the jurisdictions of at least nine municipalities in Nuevo León, and these permits must be renewed each month.[40] Transit and roadway regulations require that companies transporting cargo or loading and unloading merchandise must obtain a separate permit for each municipality in which it operates. These permits must be renewed every 30 days for a significant processing fee, and the requirements for obtaining a permit are unclear. As part of an investigation into anticompetitive regulatory barriers, COFECE concluded that this permit scheme hinders free transit and increases transactions costs, which in turn boost production and distribution costs across various economic sectors. The transportation sector represents approximately 8 percent of economic output in the state of Nuevo León. The Monterrey metropolitan area includes 70 industrial and technological parks, and trucking is essential to the local economy. At the national level, domestic shipping costs average 2 percent of the total costs of manufacturing inputs. For some industries,

Advisory Committee, three aldermen and three industrialists in the market of tortillas, who will be democratically elected among the groups of people in the branch, established for that purpose in the municipality." Article 15 further establishes that: "The Technical Advisory Committee has the power to issue an opinion on the opening and operation of the tortilla shops, as well as any irregularities or controversies that may arise regarding the requests for operating permits."

40 This is the case in the municipalities of Guadalupe, San Nicolás de los Garza, Apodaca, Escobedo, San Pedro Garza García, Santa Catarina, Juárez, Santiago, and Monterrey

such as cement products, this share rises to 15 percent. Eliminating transit permits would reduce the costs of transportation, with positive spillover effects across the Mexican economy.

Rules that are conducive to collusion or that increase the cost of competing in the market

Regulations can facilitate tacit collusion or explicit cartel agreements. While the former is generally not illegal, explicit agreements among competitors to limit competition are considered the most egregious violation of competition law. Both types of collusion reduce consumer welfare, and cartel agreements have been shown to raise prices by an average of 49 percent.[41] The theoretical and empirical literature identifies several factors that facilitate collusive outcomes.[42] In addition to structural factors (e.g. inelastic demand, regular and frequent transactions, lack of buyer power) and factors influenced by firms themselves (e.g., excess capacity), regulatory factors such as the power granted to business associations or rules that establish price floors and ceilings can encourage collusive behavior. Regulations that limit the scope for innovation and the potential variety of products can also exacerbate product homogeneity, which enables stable collusive agreement.

The subnational MCPAT identified four types of rules that promote the formation of cartels or increase the cost of competing in the market. These are: (i) rules that facilitate agreements among competitors; (ii) rules that restrict the type of products and services available, as well as their format and location; and, (iii) rules that establish price controls.

Rules that enable agreements among competitors

Regulations can allow for, or even promote, collusive agreements between competitors. Regulations requiring membership in a professional or business association to obtain market access facilitate cartel agreements. Professional or business associations may adopt mandatory rules for their members that reduce competition. Preventing associations from abusing their power may require ensuring that any self-regulation or co-regulation functions are subject to the relevant competition law enforcement and that association rules require government approval.

Regulations that support collusive behavior are both particularly harmful to competition and common across Mexican states. The subnational MCPAT revealed 102 instances of rules that promote agreements among competitors, especially by empowering associations to coordinate or self-regulate. These rules were found to be most common in the transportation and retail sectors. In the case of Mexico State, Tabasco, and Oaxaca, the WBG prioritized two reforms to address this type of rule. Examples of regulations potentially enabling cartelization in Chiapas, Mexico City and Oaxaca highlight their negative effect on competition.

In Chiapas, city officials in the city of Tuxtla Gutiérrez authorized an illegal agreement among tortilla producers to divide up the municipal territory into exclusive delivery zones. Municipal officials and representatives from two tortilla associations divided the municipality into four territories each of which would be restricted to designated set of tortilla producers, effectively creating four local oligopolies. Operational and oversight mechanisms were also entrusted to the producer associations. To deliver tortillas, a service provider had to obtain a license from the Municipal Economic Development Department authorizing its vehicles to serve a given area. The vehicles and staff uniforms were assigned a specific color for the area in which they were authorized to operate. The tortilla producers would enjoy exclusive rights in each of their territories, from which all competitors would be barred. Producers that breached the agreement could be punished by the withdrawal of their license and their expulsion from the market.

41 Connor (2014).
42 See Motta (2004) and Purfield et al. (2016) on factors facilitating cartelization in South Africa.

The authorities ruled that this agreement constituted an absolute monopolistic practice by "dividing, distributing, allocating or awarding market portions or segments in specific areas."[43] The agreement forced consumers to buy only from the tortilla delivery service that was authorized to operate in each area, violating their freedom of choice, and it entirely eliminated the potential benefits of competition between producers. The authorities imposed sanctions, and all the participating economic agents were punished, as well as the city officials that participated in or condoned the agreement, including the Municipal President.

In 2011, Mexico City strictly limited the location of supermarkets and retail shops to specific zones. The city issued an urban planning bylaw that specified zones in which new self-service shops selling food and basic necessities, clothes, footwear, and other consumer goods would be allowed to open. The rule applied exclusively to supermarkets, minimarts, convenience stores and similar establishments. Other shops that sold the same goods, such as grocery stores, public markets, and sundry shops were exempt from the rule. The purpose of the zones was "to protect public markets and small establishments from competition by self-service establishments."[44] Before the regulation had been approved by Mexico City's parliament, COFECE identified several anticompetitive implications, including: (i) segmenting the market and limiting participation; (ii) protecting incumbents from competition and thereby creating rents unrelated to efficiency; (iii) limiting consumer choice; and (iv) discouraging efficiency improvements among existing businesses. Mexico City's legislature approved the rule despite COFECE's warnings. The Office of the General Prosecutor (*Procuraduría General de la República*) later challenged the bylaw as a violation of consumer rights, and it was found to be unconstitutional. The court confirmed that federative entities should refrain from enacting policies that will negatively impact the supply of consumer goods. This decision was aligned with prior judicial rulings that regulations establishing minimum distances between competitors or exclusive zones for commercial businesses are unconstitutional because they inappropriately restrain free competition.

The State of Oaxaca established exceptional procedures to exempt certain firms from the standard public-procurement tender process, which is designed to safeguard competition and prevent bid rigging. The state government set no limit on the percentage of acquisitions that can be exempted from the standard process, allowing numerous tenders to be carried out under exceptional procedures that do not comply with competition requirements. The government also created qualitative exceptions to standard public tender procedures with no justification. State law does not prevent bid-rigging cartels from using subcontracting as a reward mechanism, as bidders are not obliged to justify the need to subcontract, and the winner of a bid is not prohibited from subcontracting to losing bidders. Moreover, public procurement units are not required to conduct market research on price levels to identify artificially inflated bids that indicate collusion.

Among Michoacán's 113 municipalities, 34 issued regulations restricting business decisions and limiting competition. Regulations affecting prices, operating schedules, and minimum distances between competitors were found in 34 municipal regulations. Minimum distances and other spatial restrictions were the most common obstacles to opening and operating a business related to the sale and distribution of tortillas. For example, the Regulation on the Dough and Tortilla Industry for the Municipality of Tancítaro, established that the municipal government, with the advice of the Municipal Union of Dough and Tortillas Manufacturers, can establish a fixed price for tortillas.

Rules that restrict the variety of products and services available to consumers

Rules that limit the variety of products and services available to consumers can damage competition. These restrictions can apply to opening hours or days,

43 This cartel was fined in 2012 by the former Federal Commission on Competition (*Comisión Federal de Competencia*). Ministry of Economy (2012).

44 Regulation 29 is intended to promote fairness and competition in the retail sector.

promotions and discounts, quality standards, the physical characteristics of retail outlets, or the number or placement of items in commercial establishments. Restrictions on the availability of products and services constrain entrepreneurial freedom, limit the potential for innovation, and weaken incentives to compete on variables other than price.

Product quality standards that advantage incumbents, or that privilege some suppliers over others, may have an especially negative impact on competition. Even when these standards effectively promote product quality—which is not necessarily the case—they may still reduce consumer welfare by preventing fully informed consumers from deciding to buy cheaper, lower-quality goods.

These restrictions are also common in Mexico. The subnational MCPAT revealed 610 instances of rules that restrict the availability of products and services. However, these restrictions are not always a priority for reform, as their impact on competition varies across markets and according to the design of the rules. In the case of Mexico State, Tabasco and Oaxaca, the WBG prioritized two reforms to address this type of restriction.

Rules that establish price controls

Price controls also distort competitive behavior. Although they vary by sector, price controls can generally be classified as either direct mechanisms such as price ceilings, price floors, or fixed commercialization margins, or indirect mechanisms through which trade associations or agents negotiate price conditions or establish pricing guidelines under government supervision.

While regulating prices in natural monopolies, such as public utilities, might be warranted, price controls can have adverse effects in competitive markets. Price floors prevent more efficient suppliers from offering goods and services at prices below the established minimum. Consequently, price floors tend to discourage efficiency while increasing producer surplus at the expense of consumers. If a price floor's purpose is to enhance product quality or safety, directly regulating those aspects of the good or service may be both more effective and less distortive. Similarly, price ceilings may reduce incentives to innovate by providing new or higher-quality products if their price would exceed the established maximum. Price ceilings can also encourage collusion between suppliers, as all prices tend to approach the ceiling, even when the product could be supplied at a lower price. Price ceilings may prompt some suppliers to exit the market, distorting the range of products available, or they may lead suppliers to impose hidden charges to circumvent the price ceiling. Price ceilings are often intended to protect consumers from high prices, but there may be less distortive means of achieving this objective. For example, if high prices reflected anticompetitive behavior, enforcing competition law and lowering barriers to entry would be preferable. In other cases, price subsidies may be less distortive than price controls.

Price controls can badly distort competition, but they are relatively uncommon in Mexico. The subnational MCPAT revealed just 56 cases of price controls.

The municipal government of Puebla regulated prices for public parking lots. In February 2007, the municipality amended its regulations to allow the municipal government to fix parking lot rates, including fines and penalties. COFECE objected to this regulation, arguing that it had an anticompetitive impact because eliminating pressure for businesses to compete by offering lower prices would reduce consumer wellbeing. COFECE's ruling went on to state that price controls were only warranted in exceptional circumstances, as a response to market failures, and should be imposed only after consultations with the competition authority.

Rules that discriminate between firms and protect vested interests

A level playing field ensures that firms compete on the merits of their products, that they face economic incentives to operate efficiently, and that resources are allocated to their most productive use. Rules that favor certain firms and disadvantage their competitors

distort efficiency incentives and slow productivity growth. An analysis of firm-level data in Tunisia revealed that barriers to entry embedded in the country's investment laws favored politically connected firms to the detriment of productivity and consumers.[45] Politically connected firms were larger than nonconnected competitors, both in terms of employment and output, and they were more profitable, but their average labor-productivity growth rate was lower. Similarly, micro-level census data in Slovenia showed that state aid to rescue and restructure struggling firms hindered the efficient static allocation of resources in the manufacturing sector.[46]

Therefore, the third category of anticompetitive government interventions encompasses regulations that unjustly discriminate between firms, or that reduce competitive neutrality and protect vested interests. These regulations typically include: (i) the discriminatory application of rules or standards; (ii) the discretionary application of rules and standards; (iii) the lack of competitive neutrality vis-à-vis government entities; and (iv) state aid or incentives that distort the level playing field.

The discriminatory application of rules or standards

The discriminatory application of rules and standards includes explicit discriminatory treatment among market entrants or against specific types of firms, such as foreign firms, small firms, or new market entrants. Restrictions that benefit incumbents are particularly damaging to competition, as they increase the relative cost of entry for potential competitors. Some policies or regulations significantly raise costs for new firms relative to existing firms—for example, regulations or policies that introduce or reinforce "grandfather clauses," under which incumbents are allowed to continue operating under an older set of rules, while new entrants are subject to a new set of rules. Grandfathering clauses can impair access of new players to limited resources needed to compete effectively.

The discriminatory application of rules is both deeply distortive and common in Mexico. The subnational MCPAT revealed 480 instances of discriminatory rules and standards which were found to be most common in the transportation sector. In the case of Mexico State, Tabasco, and Oaxaca, the WBG prioritized 10 reforms to address discriminatory rules. Examples from the State of Sinaloa highlight the negative impact of discriminatory rules on competition.

Sinaloa's state government favored local truckers when granting trucking concessions and transit permits. According to the state's 2015 Traffic Law, cargo transportation providers were required to apply to the state executive for a concession and a zone permit. The zone permit authorized the provision of transportation services only within a specific territory of the state, frequently corresponding to one of Sinaloa's 18 municipalities. The law further established that concessions and permits would be granted preferably to unions, industry alliances, and cooperative societies, even if they offered lower quality, higher prices, or did not reflect the preferences of users. This law discouraged the entry of new suppliers in the transportation market. It also segmented the market geographically and by product, and it reduced the intensity of competition between suppliers from different regions. For example, in the 18 municipalities a single concessionaire controlled more than 60 percent of the permits for transporting agricultural products.

New entrants were required to wait up to a decade for authorization. The legal framework provided little clarity on deadlines, procedures, and requirements to obtain permits. On average, it took the state 8.6 years to respond to one request. This uncertainty inhibited the entry of new service providers and discouraged investment. Due to the absence of new competitors and the length of application procedures, the Sinaloan trucking fleet was about 18 years older than the federal fleet and provided a poor quality of service. Due to the zone restriction on trucking permits, truckers could not load products outside their authorized area, and empty

45 Rijkers, Freund & Nucifora (2017).
46 Schweiger (2011)

backhauls further reduced profitability and logistic efficiency. The state also had full discretion to set or modify fees for cargo transportation and could redraw the zones at will. The authorization regime distorted prices and did not reflect market conditions. In 2015, COFECE investigated the impact of these regulations and ordered that they be amended.

The discretionary application of rules or standards

Laws and regulations that provide authorities with broad discretion to apply rules and standards can result in discriminatory treatment, even when the statutes involved do not explicitly discriminate. All laws and regulations that fail to establish objective requirements for awarding licenses, or that create oversight mechanisms with arbitrary power to impose sanctions, are vulnerable to excessive discretion, which can lead to the discriminatory treatment of firms and facilitate corruption. The unfettered authority of state or local governments to alter or cancel permits creates uncertainty, which discourages investment and promotes informality, which negative implications for competition and consumer welfare.

Excessive regulatory discretion is common in Mexico. The subnational MCPAT revealed 199 instances of the discretionary application of rules and standards, primarily in the retail sector. In the case of Mexico State, Tabasco, and Oaxaca, the WBG prioritized 13 reforms to address this weakness in the regulatory framework. Examples of excessive regulatory discretion from Mexico State highlight its anticompetitive impact.

In Mexico State, a burdensome and discretionary procedure obtaining building permits distorted competition between firms. Contrary to administrative best practices in other Mexican states, depending on the size and type of productive activity that a new or expanding store or commercial complex engaged in, Mexico State required that investment projects have a favorable Regional Impact Judgement (*Dictamen de Impacto Regional*, DIR) in order to obtain a municipal land-use license. The vast majority of municipalities in Mexico State required a DIR to execute any major commercial or infrastructure project, and in many cases small and medium commercial developments must also satisfy this requirement. Obtaining a favorable DIR requires the approval of various state and municipal entities, which lack specific deadlines for issuing their judgements, significantly increasing the cost of commercial investment.

The legal framework also granted municipalities the power to determine additional circumstances in which a favorable DIR would be required. Therefore, all investment projects were exposed to potential municipal discretion over their approval. The municipalities were also allowed to determine when the DIR would be required, increasing the unpredictability of the process and intensifying the risk of discriminatory treatment.

An analysis of the municipal requirements to obtain a DIR revealed that in practice the requirement applied to construction areas much smaller than those established by state regulations. The DIR requirement also applied to a wide variety of establishments whose operation presents no inherent risk that would justify such a procedure. Moreover, there was no correlation between the population size of the municipality and the threshold for which a DIR was required.

An analysis of the distribution of Mexico four largest retail chains—Walmart, Soriana, Comercial Mexicana, and Chedraui—across Mexico State municipalities indicates that the entry costs created by the DIR influenced their decisions regarding the establishment of new supermarkets. Municipalities that did not require a DIR for any investment types beyond those mandated in state law had a greater variety of supermarkets than did municipalities that imposed DIRs for additional investment types. The excessive discretion afforded to municipal authorities appears to have a negative impact on competition and distorts the entry decisions of investors.

The discretionary application of economy-wide regulations has also been identified more broadly

across Mexico's municipalities. The 2016 *Doing Business* report assessed the number of procedures, the time, and the cost required for a laundry business to obtain connections to the water and sewerage networks in 16 Mexican municipalities. These time and cost requirements were found to vary substantially across municipalities, ranging from three weeks to three months, and potentially advantaging some firms over others.

Lack of competitive neutrality vis-à-vis government entities

Rules that weaken competitive neutrality can distort competition by privileging SOEs over private firms. These rules may offer SOEs a range of undue advantages over private competitors, such as exclusive rights to engage in a given activity, preferential access to government land or other resources, public subsidies and loans, or an easier regulatory compliance process.

Lack if competitive neutrality is rare in Mexico. The subnational MCPAT revealed at least one instance in which competitive neutrality had been compromised. In the case of Mexico State, Tabasco, and Oaxaca, the WBG prioritized five reforms to address this issue.

In the State of Mexico, a trust established to support the development of industrial parks was allowed to directly intervene in the market. Under its regulatory framework, the Trust for the Development of Industrial Parks and Zones in the State of Mexico (*Fideicomiso para el Desarrollo de Parques y Zonas Industriales del Estado de México*, FIDEPAR) was solely focused on promoting and supporting private investment in parks owned by the state. Per its institutional policy, FIDEPAR appears to have limited its activity to market segments that would have been underserved by the private sector. However, the state also directly engaged in commercial activity in the industrial parks through FIDEPAR, despite policies to the contrary. FIDEPAR sold land (part of the assets of the trust) in the form of homogeneous lots to small and medium-sized industrial units, putting itself in direct (and unequal) competition with private real estate developers. FIDEPAR also formed public-private partnerships in which it contributed land for the construction of industrial parks by private developers, which operated under a condominium model. FIDEPAR sold lots at below-market prices, and it offered financing conditions more favorable than those offered by the private sector. Moreover, FIDEPAR itself acted as a developer, leveraging its initial land assets and drawing directly on state resources to gain an advantage over private developers. Finally, the end users of lots developed by FIDEPAR gained an advantage over competitors in non-FIDEPAR lots, as they were not required to finance the operation and maintenance services of the park.

State aid or incentives that distort the level playing field

Public authorities can distort competition by intervening in the market to support certain public or private beneficiaries. Governments can provide direct financial support via subsidies, or indirect support via tax exemptions, concessional loans, preferential access to public resources or various incentive programs. Authorities at all levels of government may employ these tools to advance various public policy objectives, but if state aid and incentive policies are not properly designed, they can skew competitive advantages in favor of certain firms.

Investment incentives granted to select firms can negatively affect competition through two channels. First, they can facilitate anticompetitive behavior by protecting dominant firms, unduly incentivize industry consolidation (which increases the risk of cartel formation), and create barriers to entry that prevent future competition. Second, they can generate inefficiency by weakening incentives to improve production and innovate, and they can drive out more or equally efficient firms that do not benefit from the incentive scheme. Therefore, investment incentives must minimize negative effects on competition while targeting a specific policy goal.

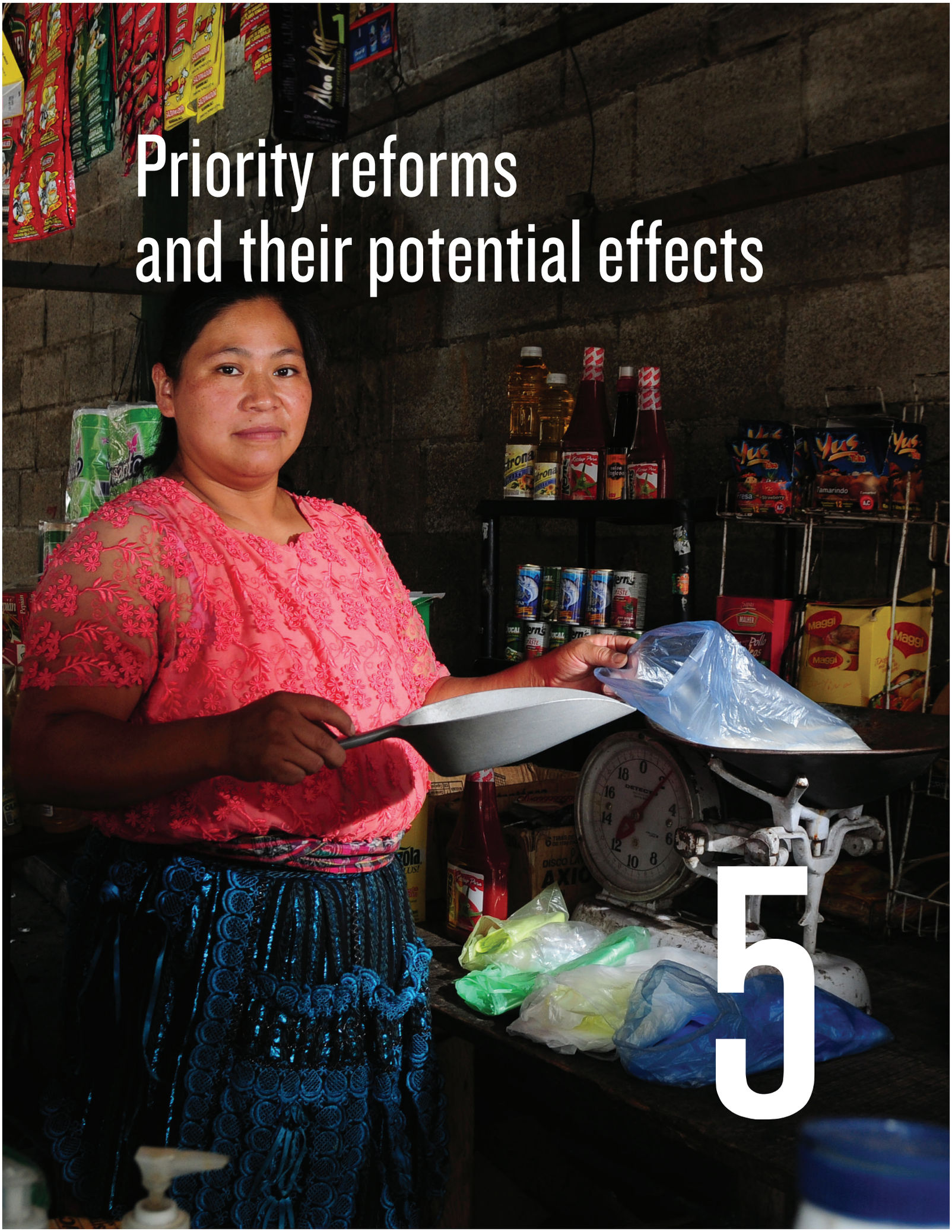
In the state of Tabasco, about 30 percent of public funds are spent on transfers, assignments, grants,

and other forms of state aid. The state government administers public trust funds that are intended to provide specific aid to help enterprises develop their activities within the state. Given the volume of resources involved, these funds have considerable potential to adversely affect the level playing field in the market. The subnational MCPAT showed that public resources were allocated without any mechanisms to ensure competition, and that the objective of these fund was neither precisely defined nor closely monitored. Many support programs pursue generic objectives and do not explicitly address market failures or advance other regulatory objectives. This situation entails a high risk that state aid is advantaging certain firms at the expense of others.

There is no system in place to prevent state aid from flowing to a small group of firms with market power. The criteria adopted to prioritize eligible projects do not account for market conditions or consider whether public funds may adversely affect competition. In several instances, public resources were allocated to companies in specific sectors without adequate transparency, leaving room for public officials to favor certain firms over others.

Limited information and transparency regarding the allocation of funds may distort the level playing field. The private sector has no access to systematic information on the availability of state aid, its allocation process, its current beneficiaries, or its impact on markets. Trust-fund rules do not require transparency regarding the amounts granted, and while a prior-assessment system is in place, it only applies to one of the trust funds and does not include potential competitive distortions. The technical committee that determines the allocation of funds includes representatives from major business associations in Tabasco, heightening the risk of favoritism.

Priority reforms and their potential effects



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The following section identifies and prioritizes reforms based on the design features and practical implementation of regulations, their interaction with specific market features, and the feasibility of altering or eliminating them. The section describes the ways in which different regulatory barriers affect competition, defines a priority set of reforms, gauges their impact on competition, and evaluates the feasibility of reforming them. The MCPAT methodology encompasses both the regulatory framework itself and its implementation. This ensures that barriers created by the actions and decisions of public officials can be identified and prioritized based on the same criteria as regulatory reforms.

Regulatory barriers will only be prioritized for reform if they are also implemented in a manner that restricts competition. This can occur in one of three scenarios. In the first, a very restrictive regulation is rigidly implemented. In the second, a regulation that allows excessive official discretion is implemented in a restrictive way. In the third scenario, a restrictive regulation exists, but is not actually implemented. Into which of these scenarios a given rule falls has a major impact on its prioritization, as even the most restrictive regulations should not be regarded as high priorities if they are not implemented. Instead, the methodology focuses on the restrictions to competition that are currently causing the most harm.

Priority reforms address regulatory constraints that exacerbate inherent market features and impede progress on critical development challenges at the local level. As discussed in the case studies throughout this note, regulatory constraints become a priority for reform if they exacerbate natural barriers to entry, conditions that facilitate collusion, or other market features that lessen competition intensity. In addition, reforms are prioritized whenever they address local economic development challenges caused by a lack of competition, such as below-average retail sales growth, low rates of capital renewal in the transportation sector, or an inadequate supply of construction-material transportation relative to consumer-goods transportation. In Tabasco, the analysis focuses on barriers to competition in the transportation of construction materials, as these are more economically distortive and more tightly enforced than barriers to competition in consumer-goods transportation.

Finally, the feasibility assessment can help to sequence short and medium-term reforms. Factors that determine the feasibility of reform include: (i) the legal status of the restrictive regulations and whether reform would require a new state law or merely an amendment to an implementing bylaw, (ii) the enforcement authorities and procedures required for reform and whether it would require only the intervention of the agency championing the reform or also other actors; (iii) the social impact of reform, including the characteristics of potential beneficiaries; and (iv) the presence or absence of political will to introduce the necessary reforms and enforce the proposed changes. Reform proposals for the retail sector in Oaxaca and Mexico State and the transportation sector in Tabasco illustrate the MCPAT prioritization process (Table 3).

The following section details how specific reforms were selected and designed as part of the subnational MCPAT in Mexico and provides two

Table 3

Selected priority reforms for Oaxaca, Mexico State, and Tabasco

	Prioritized reforms	Degree of restrictiveness to competition	Feasibility of reform	Indirect effects
Oaxaca (retail)	Eliminate rules that grant associations the right to influence decisions regarding the entry of new agents in public markets.	**High**. Associations have strong incentives to deny access to new entrants or otherwise discriminate against them.	**Medium**. The associations would likely oppose the reform.	The entry of new agents in the market would benefit consumers.
	Reduce discriminatory treatment in the granting of permits and licenses by limiting the discretion of public officials.	**Medium**. Discretion increases the risk of discriminatory treatment.	**High**. Changing the rule is within the purview of the municipal government.	Limiting official discretion would reduce uncertainty and promote competition.
Tabasco (transport)	Eliminate concessions for tourist transportation that are granted only for specific areas.	**High**. Concessions directly restrict the supply of services.	**Medium**. The local authorities have latitude to modify the regulation.	An increased supply of transportation services would directly benefit the tourism sector.
	Cease to promote agreements between competitors regarding prices and/or quality standards for each type of transportation.	**High**. These agreements weaken incentives to compete on both price and service quality.	**Medium**. The agreements already have the prior approval of the local authorities, which can reform the regulation authorizing them.	More transportation options and lower prices would directly benefit consumers
Mexico State (retail)	Modify the requirement that land-use licenses and zoning authorizations for certain projects and activities require a favorable DIR.	**High**. Obtaining a DIR unnecessarily delays the entry of competitors into the market, and the lack of uniform criteria across municipalities may restrict competition in certain areas.	**Medium**. The state has the capacity to change the DIR rules, and guidelines could be established that restrict DIR to cases in which an assessment is essential for security or zoning reasons and that limit the scope for municipalities to add further criteria.	Lowering barriers to entry would encourage investment and competition, reducing consumer prices.

Source: Licetti et al. (2016a), Licetti et al. (2016b), World Bank (2014).

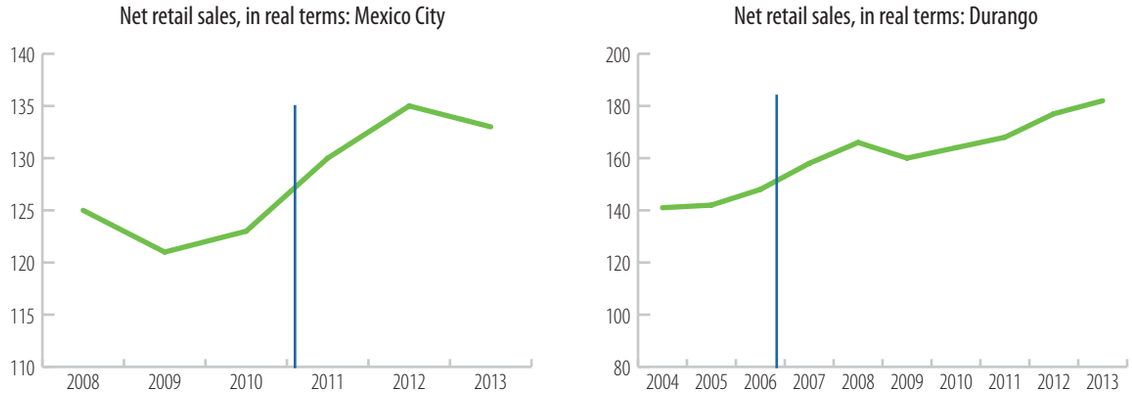
representative examples: retail reform in Oaxaca de Juárez and trucking reform in Tabasco. The examples differ in their nature and complexity, as the regulation of commercial establishments is relatively straightforward compared to the regulation of cargo transportation. Each section begins by describing the key features of the respective market, then evaluates the regulatory interventions of subnational governments, and concludes by discussing the reform scenario and its impact.

Retail reform in Oaxaca de Juárez

Key economic features of the retail market

Mexico's retail sector is a major component of many local economies. In the context of concentrated retail markets, regulatory barriers can reduce competitive pressures and create opportunities for anticompetitive behavior. Anticompetitive regulatory barriers may include regulations that restrict the number of firms or that ban private investment, regulations that set prices or facilitate anticompetitive practices, regulations that

Figure 19. Changes in retail sales after easing restrictions on opening hours



Note: The blue vertical line indicates when the municipal government eased restrictions on opening hours. 2003=100. **Source**: INEGI

restrict opening hours or grant preferential treatment to certain firms, and regulations that restrict foreign direct investment or limit trade.

Price competition is vital to market efficiency, but retail outlets also compete on service quality, location, product range and characteristics, opening hours, and parking access. Regulatory interventions in retail are often designed to protect or promote certain social values (such as the imputed cultural worth of certain types of retail spaces and enterprises) and mitigate negative externalities, such as traffic congestion, pollution, job safety risks. Given the diversity of actors involved, the interests of retailers may conflict with those of wholesalers, manufacturers, and consumers. In an effort to manage conflicting interests, many local jurisdictions regulate the establishment, location, expansion, products, and daily operations of retail outlets.

Zoning regulations on commercial real estate are among the most common restrictions on new retailers entering the market.[47] In addition to the standard administrative permits used to implement urban planning and land-use policies, municipal and local administrations often consider health, public safety, environmental issues, traffic congestion, and sometimes "commercial density" when authorizing new retail outlets. Rules on the operation of retail businesses are also very common and may address opening hours, pricing and promotional activities, and taxation.

In recent decades, local authorities in many countries have relaxed restrictions on opening hours in the retail sector. Policymakers across the developed world, but particularly in Europe and Canada, have extended retail hours of operation through Sundays and weekday evenings to promote the growth of retail commerce. The international literature presents evidence that such reforms are associated with accelerated economic activity and productivity growth. For example, the deregulation of opening hours in the United States has been linked to a 5 percent increase in employment and a 4-11 percent increase in sales.[48]. In India, extending operating hours increased labor productivity by almost 87 percent.[49]

Retail segments regulated by subnational authorities

In Mexico, municipal governments set rules and regulations on the retail sector. Municipal regulatory

47 Boylaud & Nicoletti (2001); Spanish Defense Competition Tribunal (2003); de los Llanos Matea & Mora-Sanguinetti (2009).
48 Kitzmuller & Licetti (2012).
49 Amin (2009).

powers usually encompass retail licensing, zoning requirements (including minimum-distance rules), hours of operation, and other commercial conditions. In some cases, municipalities have imposed price controls. Segments of the retail sector that are usually under the purview of municipal authorities include: (i) commercial establishments (e.g., supermarkets, retail chains, minimarts, and convenience stores); (ii) public markets; (iii) street vendors.

Municipalities across Mexico impose rules restricting businesses' opening hours. While many municipalities have eased restrictions, allowing retailers to remain open longer, most maintain strict limits on hours of operation. However, the available evidence suggests that municipalities that loosened restrictions on opening hours experienced an increase in retail sales in the months that followed (Figure 19).

Reforms in Oaxaca and their effect

In Oaxaca, the retail subsector represents 15 percent of economic output. The number of retail businesses and the sector's share in total employment underscore the importance of retail to the state's economy. In 2008, the commerce sector encompassed 47.7 percent of registered businesses in the state, of which 95.8 percent operated in the retail subsector, and commerce contributed 40.6 percent to total employment, with 88.7 percent of commercial workers employed in the retail subsector. Microenterprises make up 99 percent of retail businesses and 89.2 percent of wholesalers, making the retail sector a key area for entrepreneurship and microenterprise development.

According to the National Institute of Statistics and Geography (Instituto Nacional de Estadística y Geografía, INEGI), the city of Oaxaca de Juárez was the state's main tourist destination. In 2013, almost one million tourists visited Oaxaca de Juárez. The size of the tourism sector magnifies the importance of commercial services.

Following WBG recommendations, Oaxaca changed its bylaws regulating commercial establishments. The reform bill was developed by the Mayor's Office, the local Secretary for Economic Development, and CONAMER, with technical input from the World Bank. Among other changes, these reforms allowed the Business Attention Unit (*Unidad de Atención Empresarial*) to directly authorize changes to opening hours for all establishments of low or medium risk, potentially enabling businesses to remain open 24 hours a day, which increased regulatory predictability and transparency.

Two key elements of the reforms' success were direct engagement with municipal policymakers and the integration of lessons learned from the international evidence into the design of the reform measures. CONAMER's local counterpart in charge of regulatory improvement continuously advanced the reform dialogue and strategically positioned the topic on the agenda of local policymakers, enabling CONAMER and the WBG team to present policy options directly to the relevant authorities. In these presentations, evidence of the link between flexible opening hours and retail sales and productivity played a significant role in making the case for reform. To address local concerns regarding safety and public order, the WBG team proposed a differentiated approach with respect to the sale of alcohol. For example, among establishments that sell alcohol in closed containers, such as supermarkets, opening-hour restrictions should be applied only to the sales of alcoholic beverages, not to the other operations of the business.

The reforms increased market entry and promoted the expansion of existing firms. The largest chain of convenience stores immediately extended its opening hours, and between January and August of 2016, 26 companies extended their opening hours, compared with only one in 2015.[50] Meanwhile, another national chain announced plans to open 24 new outlets in Oaxaca.[51] This chain employs an innovative "superpharmacy" business model that combines the services of a regular

50 CONAMER (2016).
51 *Brecha* (2016); *e-Oaxaca Digital Magazine* (2016); FRAGUA (2016).

Box 5

The Effect of Opening-Hour Restrictions on Retail Sector Performance

Using data on municipal regulations restricting the opening hours of retail outlets, Licetti & Dauda (forthcoming) examine the relationship between easing these restrictions and the growth of real retail sales. This study uses 2001-2013 municipality-level data from multiple sources. The principal data source for the outcome variables and most of the covariates is INEGI. The outcome variable, the annual average of the net retail sales index, comes from INEGI's Monthly Survey of Commercial Establishments (*Encuesta Mensual sobre Empresas Comerciales*). The second data source is a database of municipal bylaws regulating retail commerce at the municipal level jointly compiled by CONAMER and the WBG. The analytical sample includes 32 of the 37 cities for which INEGI has information on retail sales indices.

To evaluate the effect of opening-hours restrictions on retail sales outcomes, the analysis estimates a cross-sectional time-series regression:

$$lnQ_{it} = \tau_t + \psi' X_{it} + \beta_q \sum_{q=2}^{4} D_q + \varepsilon_{it} \qquad (1)$$

where lnQ_{it} is the logarithm of the annual average of the index of real net retail sales in municipality i at time t, τ_t is year fixed effects, and X_{it} is a vector of municipal-level variables that have been found to be important predictors of retail sales. The key independent variables are three indicator variables that split the mean hours of operation across standard store, restaurant, and supermarket subgroups into quartiles, with the cutoffs (D) based on the pooled distribution, to obtain different levels of restrictiveness.

The results reveal that easing restrictions on retail shopping hours can have a positive effect on real retail sales growth. The findings imply that a change from the bottom to the top quartile of mean hours of operation across the standard store, restaurant, and supermarket subgroups (equivalent to an increase in mean hours of operation of about 4.75 hours) would lead to about a 6.8 percent increase in the annual average rate of real retail sales growth.

Extending operating hours could lead to more robust competition, as the most inefficient and inadaptable retailers exit, new retailers enter, and successful retailers expand, as well as greater efficiency, increased economies of scale and scope, and expanded consumer access to retail goods and services. Balancing the benefits of extending opening hours with the concerns of interest groups requires the development of regulatory tools that foster a competitive environment while advancing public-policy objectives.

Source: Dauda, Goodwin & Licetti (forthcoming).

pharmacy with those of a convenience store, and the viability of this model depends on the ability of outlets to remain open 24 hours.

These reforms are associated with the growth of retail sales. Empirical estimates that control for time- and municipality-specific effects suggest a significant correlation between reform easing restrictions on opening hours and the growth of retail sales. The reforms in Oaxaca are expected to boost the average annual growth of retail sales by 6.8 percent (Box 5).

Trucking services reform in Tabasco

Cargo transportation is vital to the development of local markets in Mexico, as it affects the input supply of most local industries and connects production, distribution, and consumption within and between Mexican states. Given Mexico's geography and limited

rail network, road transportation (i.e., trucking) is the most common transportation method. Historically, Mexico's state and municipal authorities have heavily regulated the trucking sector. These regulations were originally predicated on the assumption that trucking is a public service that affects the core interests of the state, and regulatory interventions in the trucking sector usually aim to control market variables such as market entry, prices, and service quality. However, many state and municipal regulations on trucking do not reflect market conditions, distort competition and create perverse incentives, as COFECE and CONAMER have reported in analyses of several Mexican states.[52]

A COFECE market study focused on Sinaloa's cargo-transportation sector highlighted several restrictions to competition and recommended major reforms to the regulatory regime, as discussed above.[53] Following this study and related advocacy efforts, Sinaloa's state government amended the regulatory regime to promote greater competition in trucking services. Key reforms included replacing the concessions regime with a scheme in which all firms interested in providing trucking services could participate.[54]

Key economic features of the cargo-transportation market

Different segments of the trucking sector have different technical and market characteristics. For example, the nature of the products that need to be transported determines key service requirements—such as refrigerated containers for certain agricultural products—and the distances involved determine the modes of transport required. The WBG's MCPAT transportation and logistics module application provides a detailed analysis of the different segments of the trucking market and various forms of regulatory intervention.[55]

In general, the market for cargo transportation is characterized by derived demand. Demand for transportation services directly reflects demand for goods, and thus the size of the transportation-services market depends on the size of the market for the goods to be transported. In regions with little production or retail consumption, cargo transportation services will be limited. However, the efficiency of transportation services also influences the price of the products being transported, and high transportation costs may discourage the production of goods for distant markets or reduce demand for inbound consumer goods.

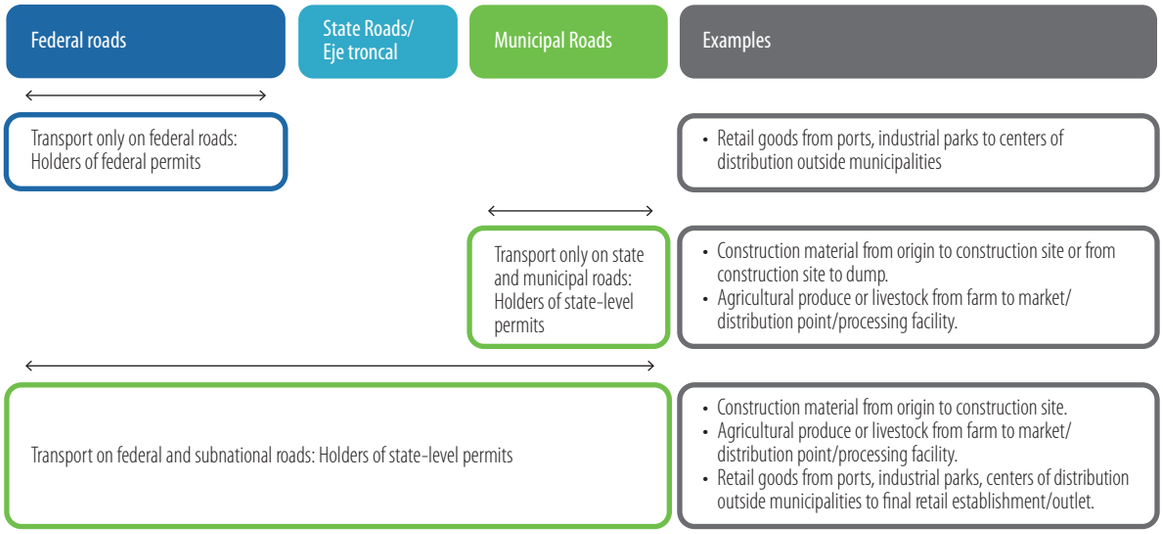
The power of subnational authorities to regulate trucking

State and municipal governments regulate transportation on state and municipal roads. State and municipal roads include those located within a municipality's borders and, in some cases, those that connect municipalities within the same state. However, most municipalities are connected by federal roads. Because federal transportation permits tend to be easier to acquire than subnational permits, routes that involve both federal and subnational roads are typically serviced by holders of a subnational transportation permit. Consequently, the subnational regulatory regime primarily affects transportation services within or between municipalities of the same state.

There is no substitute for trucking in much of Mexico. Local routes between municipalities are seldom substitutable for rail or maritime transport, and even the transportation of goods by producers, wholesalers, or retailers themselves (rather than by third-party trucking companies)[56] requires a state-level permit. Therefore, the Tabasco-specific market scenario reflects the assumption that commercial trucking has no near substitutes (Figure 20).

52 COFECE has found significant barriers to competition in the cargo transportation sector in Nuevo León, Tlaxcala, and 17 other states. See COFECE (2016a) and COFECE (2017).
53 Ministry of Economy (2017); *Mexicoxport* (2017).
54 El Financiero (2017); State Government of Sinaloa (2017).
55 Begazo et al. (forthcoming).
56 In Mexico, this is known as "private transport" (*transporte privado*).

Figure 20: Overview of the Trucking Industry in Tabasco



Source: Author's elaboration. Note: This includes transport for third-parties and transport for own account (private), as for both activities, the state requires a permit.

Transportation that originates and/or terminates on roads under subnational jurisdiction typically falls into three categories. These include: (i) the transportation of retail goods from ports, industrial parks, warehouses or other distribution centers outside the municipality to the final retail outlet in the municipality, (ii) the transportation of agricultural produce or livestock from farms to marketing points, distribution centers, or processing facilities, and (iii) the transportation of construction materials from their point of origin to the construction site or from the construction site to the dump. Smaller-scale, less-frequent forms of transportation may include moving furniture or other larger household items.

Because the commercial transportation sector is driven by derived demand, the composition of the state economy influences the size and development of the trucking industry. For example, because agricultural production in Tabasco has significantly declined, there is little demand for the transportation of agricultural produce. However, the decline in the agricultural sector may itself result from prohibitively high transportation prices due to limited competition. Meanwhile, because Tabasco has numerous construction-material producers, the transportation of construction material is an important economic activity.

The analysis considers demand for local road cargo transportation of agricultural produce, construction materials, and retail goods. Competition in these subsectors is typically viable, as economies of scale in these segments do no generate a significant degree of market power nor create a natural monopoly, and a market equilibrium with multiple competing operators is generally economically efficient. However, specific types of trucking services may be subject to market failures that justify government intervention, and like other types of transportation, trucking creates negative externalities such as pollution, congestion, and safety risks. The government may therefore establish certain behavioral and material standards for vehicles and service providers.

Reform scenarios in Tabasco and their effect[57]

Located in southeastern Mexico, Tabasco is favorably positioned to serve as an overland logistics hub, particularly for the Yucatan peninsula. The state produces significant quantities of petroleum and natural gas, it has a large mining sector, and it produces construction materials demanded within Tabasco and by neighboring states. These economic characteristics highlight the importance of an efficient trucking industry.

The 2014 Transportation Law establishes the regulatory framework for providing transportation services in Tabasco State.[58] The law provides for two types of cargo services: (i) the transportation of goods and merchandise and (ii) the transportation of construction materials. In both cases, the regulatory framework grants exclusive rights to transportation concessionaires to provide these services within their respective concession areas. Thus, each municipality in Tabasco has one transportation union that exclusively provides transportation services. New concessions are granted at the discretion of the state authorities, which must declare "the necessity of the service" based on studies of supply and demand. Private firms are not allowed to apply for new concessions outside this context. Finally, the law permits firms to transport their own goods, but only so long as doing so is not deemed to be "in conflict" with the exclusive rights granted to concessionaires.

In both segments of the trucking industry, the regulatory framework diverged from the reality of the market. The services provided by concessionaires were not capable of meeting demand, and other actors covered the shortfall. The Tabasco trucking industry has been growing more slowly than the national average, and the concessionaire fleets are old and do not meet the capacity requirements and technical standards demanded by clients.

Although the regulatory model created a series of local monopolies in trucking services, the state authorities did not effectively supervise concessionaires, maintain service-quality standards, or authorize new concessions when demand conditions warranted an increase in supply. For this regulatory model to function, the state government would have to closely supervise the cargo-transportation union and ensure that the supply and quality of trucking services were adequate to meet demand. The authorities would also have to ensure that trucking services were provided only by authorized concessionaires. In practice, however, the state government did not meaningfully supervise these aspects of the trucking industry. In some cases, the union unjustifiably refused to render services and faced no sanctions from the authorities. Moreover, the administratively determined trucking rates far exceeded a competitive equilibrium, generating a price distortion that negatively affected consumers.

These restrictions caused significant inefficiencies not only in the cargo transportation sector, but also in sectors dependent on it, with especially negative impacts on small firms and entrepreneurs. Because they are protected from competition, concessionaires have no incentive to improve service quality or invest in their vehicle fleet. Price is an especially important variable in the trucking industry, as it affects the availability of services, the number of trips required, and the efficiency of transport logistics. Because prices were set administratively and did not reflect market conditions, efficiency incentives were largely nullified.

The transportation of construction materials is an especially important economic activity in the State

57 Under the Agreement of Technical Cooperation between the Ministry of Economic Development and Tourism of the State of Tabasco and the World Bank, signed on February 19, 2014, the World Bank and CONAMER carried out an analysis of state and municipal regulations to identify opportunities to improve competition and promote private investment in key sectors of the State of Tabasco. One of these sectors was cargo transportation.

58 According to Article 8 of the Transportation Law of Tabasco, the provision of public transportation services is under the purview of the state's executive branch. Individuals and firms have no preexisting right to provide transportation services, except as authorized by concessions and permits. Concessions are granted within the territory of each municipality, and only carriers that are members of the municipal union are eligible to receive them.

of Tabasco. The transportation union with the largest number of concessions for this service in Tabasco had 253 vehicles, and its annual turnover was approximately MXN 10 million (roughly US$530,000). The public sector was the primary source of demand for the transportation of construction materials.

As with goods and merchandise, demand for the transport of construction materials could not be satisfied by the concessionaires. This problem could be mitigated by construction companies transporting materials themselves, but many lack the capital to invest in their own vehicle fleets. Small firms have especially limited options in this regard, and the high prices charged by transportation companies constrain the growth of their businesses. Moreover, the transportation authorities have repeatedly denied self-transportation permits on the grounds that they infringed on the rights of unions.

Furthermore, even construction companies that obtained permits for self-transportation and utilized their own vehicles were still forced to use union services. In several cases, the unions physically blocked the trucks of construction companies that were loading construction materials from suppliers and demanded a portion of the load. In those cases, the transportation authorities acted as mediator but effectively sided with the unions, asking both parties to share the load. However, because the union fleet was often not suitable to transport the required construction materials, in several cases the construction companies paid a "fee" to the unions, even though they were using their own fleets. On the other hand, the unions report the authorities do not adequately enforce the rights of concessionaires, exposing them to "unfair competition."[59]

High prices and low service quality prompted many construction firms to employ informal service providers. Construction firms and other users preferred using informal alternatives to the unions due to their lower prices, which were well below the administratively determined rate, and the higher quality of their vehicle fleets. Both factors suggest that even if the authorities tightened control over unauthorized suppliers, the union would not be able to meet the demand for the transportation of construction materials.

Following this analysis, the WBG team estimated that transportation concessionaires were unable to service 75 percent of the total volume of cargo transportation in the State of Tabasco. The team prioritized the construction-materials subsector due to its economic importance to Tabasco State. Moreover, inefficient outcomes in this market segment adversely affects other key economic activities, such as construction, and impacts both the private and public sectors.

To preempt political-economy challenges, the team identified and interviewed a large set of relevant stakeholders. The World Bank and CONAMER teams spent several weeks interviewing representatives from a majority of transportation unions in the State of Tabasco, including those that were more economically viable and those which were so inefficient that most members had already turned to other economic activities. These interviews gave a more complete picture of various stakeholders' economic interests and informed the recommendations for sequencing pro-competition reforms. The teams also engaged with associations of construction companies, the main stakeholders affected by suboptimal cargo transportation in Tabasco, and learned about the potential economic gains generated by more competitive cargo rates.

The reform program's alignment with the strategic objectives of the state government increased buy-in. The WBG team presented the findings of the study to the Governor of Tabasco, who instructed that the World Bank, CONAMER, and state government officials, including the Secretary of Transportation, propose a joint action plan for implementing gradual pro-competition reforms in the construction-materials transportation subsector. The Governor and other state officials were motivated by the finding that trucking reforms could improve the state's competitive position, especially in the context of recent federal energy reforms, which could attract significant

59 The information in this paragraph is based on interviews with stakeholders in Tabasco conducted by the WBG team.

Box 6

The pro-competition reforms in Mexico's national trucking sector

Pre-reform context

Prior to 1989, trucking on federal highways in Mexico was subject to a rigid regulation and substantial government interference, which created a highly inefficient system that did not allow companies to compete with one another on price or service quality. The regulatory framework had been established in 1977 by the Ministry of Communication and Transport (*Secretaría de Comunicaciones y Transportes*, SCT) and was intended to protecting transportation infrastructure and provide more reliable services, as it was believed that open competition might increase price volatility and encourage trucking companies to engage in dangerous cost-cutting practices.

The pre-reform environment imposed numerous barriers to market access, especially the requirement to obtain a federal trucking concession from the SCT to provide general freight services in one of the country's 11 national transit corridors. Truckers were also obliged to load and unload cargo at specified freight centers, and shippers had to channel requests through these centers, which constrained entry and fostered the formation of cargo-assignment cartels. Official trucking tariffs were set by the SCT and did not reflect costs, as they were unresponsive to supply and demand conditions. The cartelization encouraged by government restrictions weakened efficiency incentives, imposing costs on industries and sectors across the economy.

In this context, the government formulated a new policy framework to deregulate the trucking industry. The trucking deregulation program, launched in 1989, was undertaken within the framework of a general macroeconomic reform that followed the debt crisis, and not as an isolated action.

Stages of the reform process

Having observed the success of deregulatory reform in the United States, the Ministry of Finance (*Secretaría de Hacienda y Crédito Público*) and the Ministry of Commerce and Industrial Development (*Secretaría de Comercio y Fomento Industrial*) began deregulating the trucking industry through a three-stage process. The first stage was to request support from the affected industry associations, emphasizing modernization rather than deregulation and not openly mentioning increased competition as an objective. This approach enabled the government to negotiate a collaboration agreement with the national trucking association (*Cámara Nacional de Autotransporte de Carga*, CANACAR). The second stage consisted of approving the new regulations, which eliminated most restrictions, and debunking the idea that a tightly regulated trucking industry was consistent with the public interest. Finally, the third stage involved abandoning price ceilings, which allowed rates to be freely negotiated between truckers and customers, and replacing the concession system with a permit system over which the federal authorities no longer exercised any discretion.

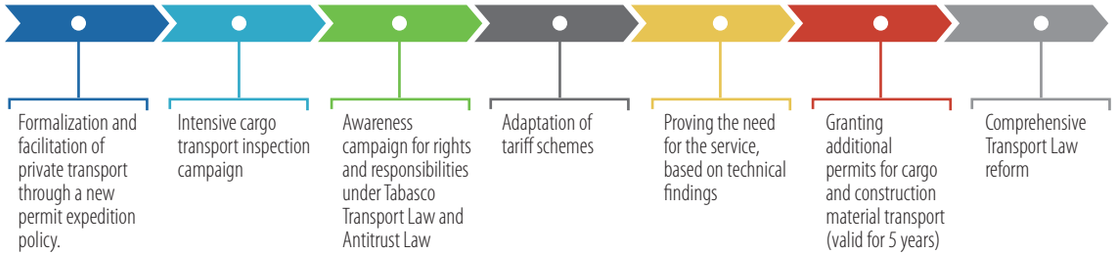
Following the reform, previously favored market participants attempted to replace government control with interfirm agreements. This was confirmed by an ex officio investigation carried out by the Mexican Federal Competition Commission (*Comisión Federal de Competencia*), which discovered a price-fixing agreement among members of CANACAR. The agreement was deemed to be a violation of the competition law, and CANACAR was punished with a fine.

Results of the reform

The results of the reform were overwhelmingly positive. The entry of new firms, the expansion of existing firms, and the legal registration of a number of formerly unregistered firms led to a dramatic 125 percent increase in haulage units. The intensity of competition dramatically increased, and prices fell as output rose. Moreover, the reform fostered greater economy-wide innovation and growth, prompting a sharp decrease in delivery times and transit loses due to better logistics quality and giving consumers access to new products by direct delivery, which had previously been unavailable due to inflexible transportation services.

Source: Dutz, Hayri and Ibarra (1999).

Figure 21: A proposed action plan for pro-competition reform in the cargo-transportation sector



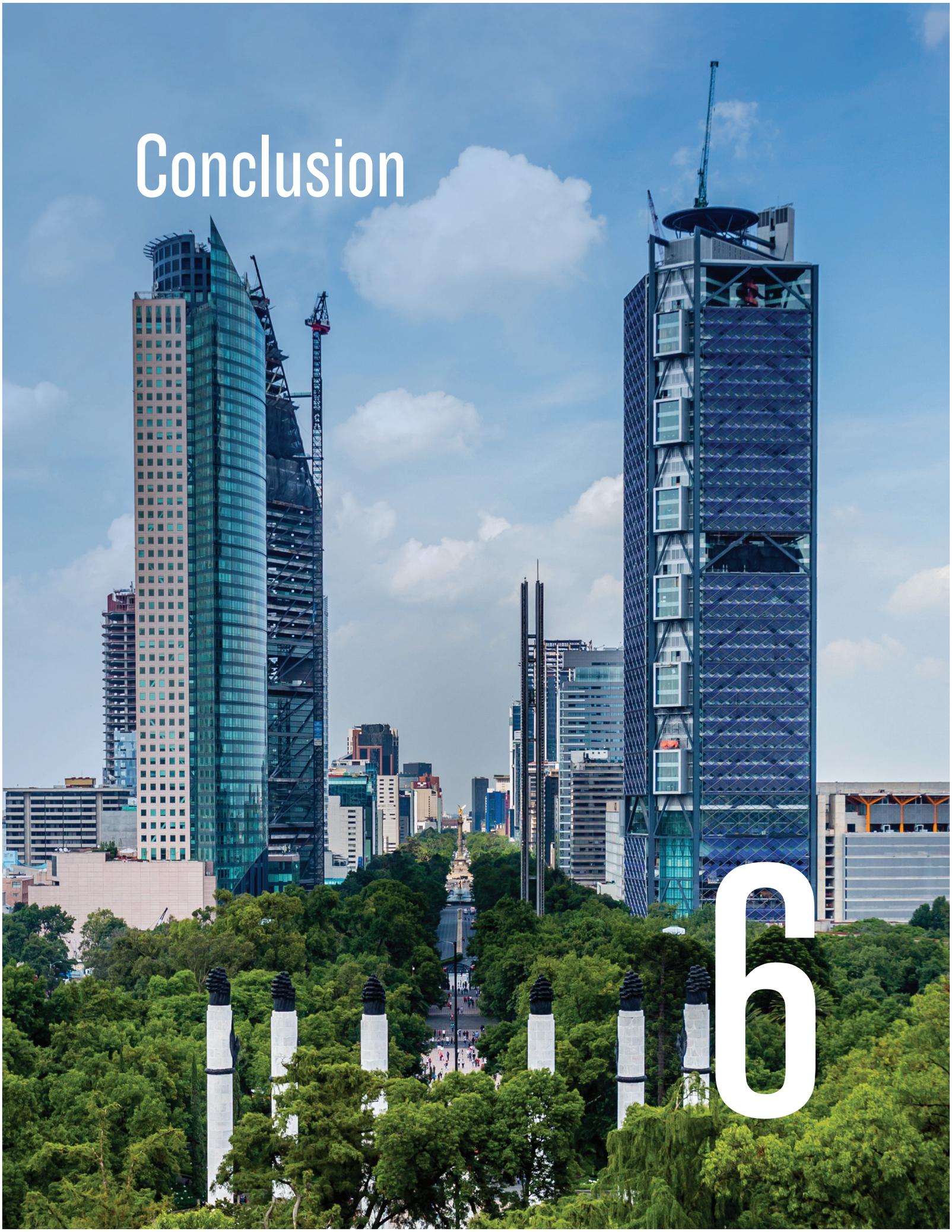
investment. In addition, the WBG team estimated that more efficient cargo transportation system reduce road-construction costs by as much as 15 percent.

Nevertheless, the reform process was expected to be a politically sensitive undertaking. In Tabasco, as in many other Mexican states, the cargo-transportation sector involves a large share of unskilled workers, including truckers employed by firms and self-employed truckers (*hombre-camión*). A reform process would rearrange the sector, potentially disrupting the income stream of workers who may have difficulty finding alternative employment. Moreover, many local cargo-transportation industries are dominated by powerful unions with significant political influence.

However, the highly positive spillover effects of a more efficient transportation sector could help the government leverage multi-stakeholder engagement to overcome the political clout of concentrated interest groups. A carefully designed action plan was vital to the success of the proposed reforms, and Mexico's experience with similar pro-competition reforms at the federal level could serve as a blueprint. Indeed, many of the market features that prevailed in Tabasco's trucking industry were also found in other Mexican states (Box 6).

Policymakers in Tabasco State could successfully reform the cargo-transportation sector by implementing politically feasible measures that will have a meaningful impact on competition. The state government could begin by issuing more permits for firms to transport their own goods and supplies, which would require no change in any legal instrument. To address concessionaires' claims regarding unauthorized transportation services, the authorities could commit to tighter enforcement of the law. A campaign to raise public awareness of the provisions of the Transport Law and the Federal Antitrust Law could help prevent illegal collusive agreements on among concessionaires. Shifting from the current system of fixed rates to a rate band, with the current rates set as the maximum, could allow current concessionaires greater flexibility to attract customers by charging lower rates (e.g., through discounts and temporary promotions). Once these preliminary administrative reforms have been completed, the authorities could move forward with the legislative elements of the reform process (Figure 21 and Annex III).

Conclusion



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Productivity growth is among Mexico's most pressing macroeconomic challenges, and increased competition can catalyze firm-level efficiency improvements, facilitate the growth of more-efficient firms, and yield substantial welfare gains. Mexico's national productivity growth rate is low, and southern states tend to perform especially poorly. Competition can boost productivity in lagging states by promoting a more efficient allocation of resources, and it can both increase the quality and lower the prices of consumer goods and services. The resulting welfare gains can have a highly positive impact on lower-income households. Conversely, uncompetitive markets cost the poorest households an estimated 20 percent more than the richest[60].

COFECE and CONAMER are well positioned to address regulatory restrictions to competition at the subnational level. State and local government interventions distort competition in key sectors such as transportation, retail, construction, and agriculture. COFECE can advocate for pro-competition reforms, while CONAMER can build on its institutional network to expand the regulatory-improvement agenda to encompass barriers that affect specific markets and market dynamics.

The WBG's subnational MCPAT was designed to address a critical gap in competition reform that could unlock key markets for local development. The application of the MCPAT to Oaxaca in the pilot phase, and then upon request to Tabasco and the State of Mexico in partnership with CONAMER, provided a solid foundation for CONAMER to expand the tool to all 32 federative entities. In total, 520 restrictive regulatory provisions have already been identified, most in the retail, construction, and manufacturing sectors.

The reform process in Tabasco and Oaxaca underscore the value of identifying inherent market features that may be exacerbated by regulation and designing measures that carefully balance political feasibility with local economic impact. In Oaxaca, amending retail bylaws to loosen restrictions on operating hours attracted new investment and boosted sales. The reforms advanced the state's objectives of increasing competitiveness and addressing poverty, which helped build the political will necessary to overcome opposition from vested interests. In Tabasco, the reform strategy was designed with the support of the state's Governor and precisely targeted the market segments where restrictive regulations created a critical bottleneck for the local economy.

Further reforms to boost competition in priority sectors are currently being prepared. Upon completing the *Justicia Cotidiana* program in mid-2018, CONAMER will have delivered detailed reform memoranda to 32 federative entities. In Campeche, Querétaro Guanajuato, Baja California Sur, Chihuahua, Colima, and Sonora, state authorities have already initiated the legislative process to modify the regulatory framework in line with the recommended reforms. CONAMER continuously monitors reform progress and highlights exemplary initiatives during their well-publicized and politically significant Annual National Regulatory Improvement Conference.

60 Urzúa (2013).

Building on the MCPAT assessments, the government recently passed a new law expanding CONAMER's regulatory improvement program for state and municipal governments. The 2018 General Law on Regulatory Improvement (*Ley General de Mejora Regulatoria*) requires CONAMER to implement a reform program targeting priority sectors, continuing the work launched by CONAMER and the WBG under *Justicia Cotidiana*. This program, inspired by the MCPAT, will transform subnational regulatory pro-competition reform from an individual initiative to a formal public policy. The law requires subnational governments to undertake an ex ante RIA that includes a competition assessment, and the MCPAT checklist could inform this assessment as well.

The MCPAT analysis and subsequent reform experience can provide a platform for knowledge exchange and increase reform momentum. The data generated by CONAMER on the regulatory framework for priority sectors with help of the MCPAT, and the experience gleaned from the reform process to date, can complement the new mandate for subnational regulatory improvement. A more systematic empirical assessment and impact evaluation could also inform a national strategy to promote reforms in several states simultaneously. COFECE will continue to take determined action against anticompetitive practices and investigate regulatory provisions that may create barriers to entry or facilitate cartels, both of which can provide a powerful incentive for subnational governments to voluntarily remove of anticompetitive restrictions. The experience gained through the subnational MCPAT may also be relevant in other contexts, and several countries have already requested WBG support to apply a similar regulatory analysis.

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Annexes

Annex I. Institutional Mandates for Regulatory Reform

COFECE has institutional powers to investigate and determine essential inputs or barriers to competition.[61] Under the new legal regime, the Mexican federal law on economic competition provides a special procedure for detecting and declaring barriers to competition and essential inputs. COFECE can initiate this process, either ex officio or at the request of the Federal Executive, when there is evidence of a lack of effective competition in a given market. If, upon completion of the investigation, the investigating authority determines that there is a lack of effective competition in the investigated market, the authority shall issue a preliminary opinion within sixty days (60). Otherwise, the authority must propose that the plenary close the file. The authority must issue a resolution, which may include:

a) **Recommendations to public authorities** to eliminate regulatory barriers to entry or to take regulatory action within the scope of their legal competence to promote more competition in the investigated market. The decisions and recommendations should be publicized;
b) **An order to the corresponding economic agent** to eliminate a barrier that unduly affects competition in the investigated market; or
c) **The divestiture of assets, rights, or social parties, or compulsory action by the economic agent,** necessary to effectively eliminate barriers to competition, though only when other corrective measures are not sufficient to solve the identified competition problem.

In all cases, COFECE must verify that the proposed corrective measures will increase market efficiency. Therefore, no corrective measures will be taken when barriers to competition generate efficiency gains or have a positive effect on competition that outweighs their anticompetitive effects. When COFECE rules that barriers to competition exist, the authorities in charge of regulating the relevant sector must be notified of the decision so that they can determine an effective strategy for increasing competition.

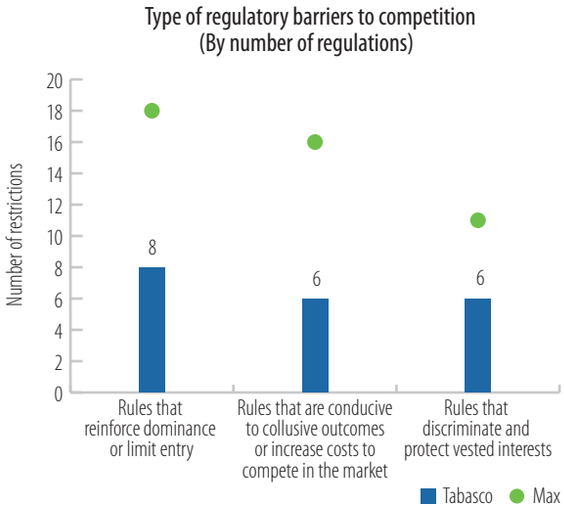
In March 2018, the Chamber of Deputies of Mexico approved the initiative presented by CONAMER to enact a New Mexican Regulatory Improvement Law. President Peña Nieto signed the law into effect in May 2018. The new law is designed to promote the improvement of the regulatory framework at the federal, state and municipal levels, and it will introduce a subnational regulatory impact analysis (RIA).

The new RIA must be applied to all regulatory proposals at the federal and subnational levels. Regulatory-improvement agencies will be set up at the subnational level, and all government agencies will be required to conduct RIAs before enacting regulations. Under the law, the process of design regulations, regulatory proposals, and their corresponding RIAs should focus primarily on ensuring that regulations are consistent with economic competition. In addition, the RIAs will establish a structured analytical framework to help government agencies at all levels study the effects of the regulations and regulatory proposals, in consultation with the public. The new law also requires that government authorities at all levels adopt schemes for revising their regulatory proposals through RIAs. To improve existing regulations, regulatory-improvement agencies may request that other government agencies carry out ex post RIAs, and they may propose recommendations for amending the current regulatory framework.

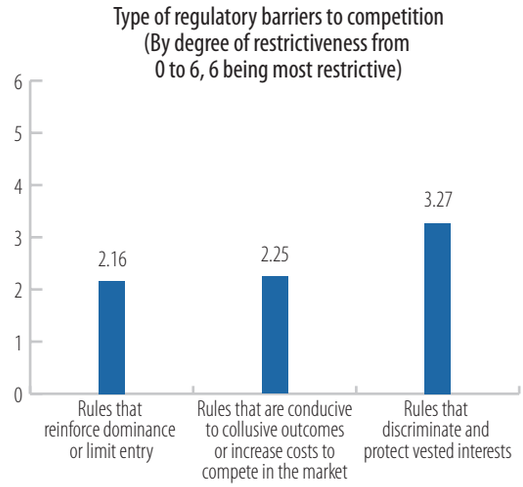
61 Articles 94 to 96 of the Mexican Federal Law on Economic Competition.

Annex II. Regulatory Restrictiveness in Oaxaca, Tabasco, and Mexico State

Figure A2.1. Tabasco: Anticompetitive Regulations in the Transportation Sector

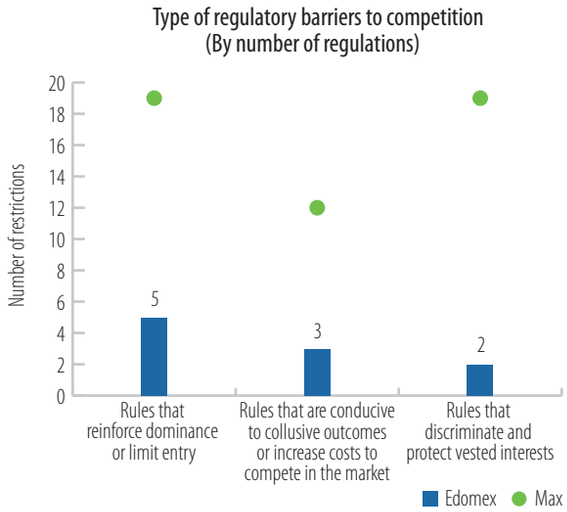


Note: This graph reflects all potential regulations that restrict competition (e.g., granting of temporary exclusivity) and classifies them into general and specific categories. In the category "Rules that reinforce dominant positions or limit entry", there are 18 types of restrictive regulations in the transportation sector ("max"). Of these 18, 8 have been found in Tabasco. **Source:** Authors' elaboration based on information provided by Tabasco's Secretary of Economic Development.

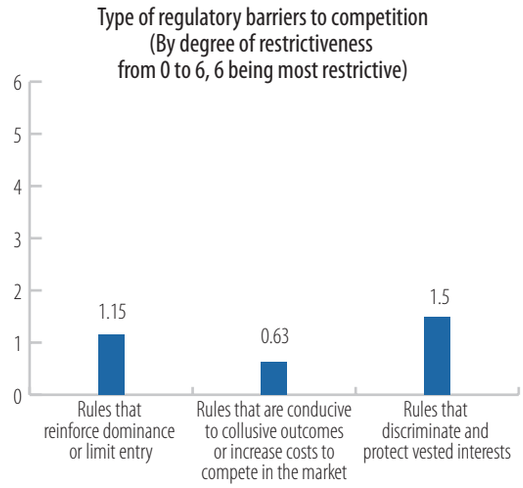


Note: This graph is based on the same list of regulations as the one on the left. However, within each category, those restrictions on competition that are more restrictive to competition have been identified (e.g., absolute barriers to entry versus relative barriers) and have been weighted twice as much as those that are less restrictive. The sum of the weighted restrictions is normalized to a value of 0 to 6. Although Tabasco imposes more restrictions on the number of companies, regulatory barriers in the category "Rules that discriminate and protect vested interests" are the most restrictive. **Source:** Authors' elaboration based on information provided by Tabasco's Secretary of Economic Development.

Figure A2.2. Mexico State: Anticompetitive Regulations in the Retail Rector

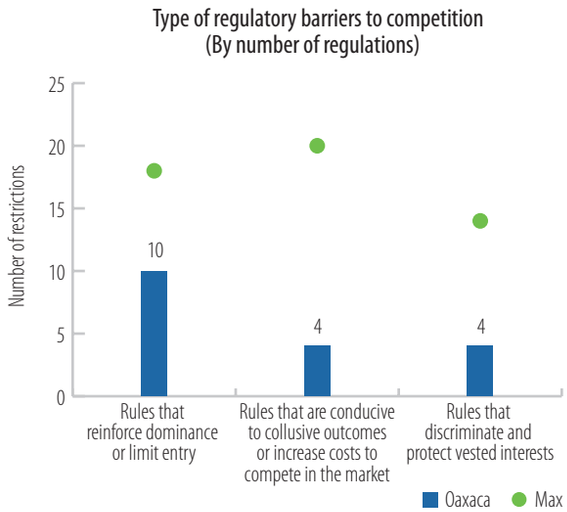


Note: This graph reflects all potential regulations that restrict competition (e.g., granting of temporary exclusivity) and classifies them into general and specific categories. In the category "Rules that reinforce dominant positions or limit entry", there are 19 types of restrictive regulations in the transportation sector ("max"). Of these 19, 5 have been found in Mexico State. **Source:** Authors' elaboration based on the information provided by Mexico State's Secretary of Economic Development.

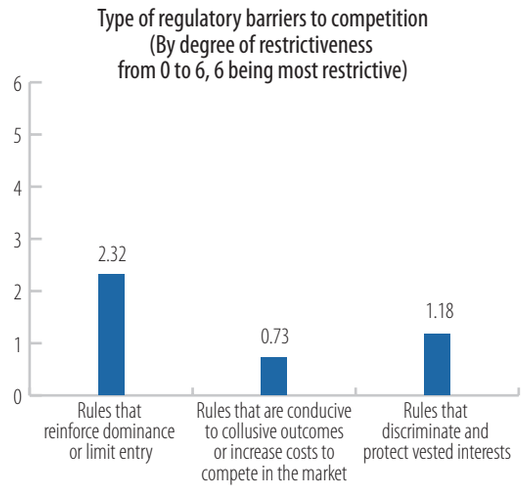


Note: This graph is based on the same list of regulations as the one on the left. However, within each category, those restrictions on competition that are more restrictive to competition have been identified (e.g., absolute barriers to entry versus relative barriers) and have been weighted twice as much as those that are less restrictive. The sum of the weighted restrictions is normalized to a value of 0 to 6. Although Mexico State imposes more restrictions on the number of companies, regulatory barriers in the category " Rules that discriminate and protect vested interests " are the most restrictive. **Source:** Authors' elaboration based on the information provided by Mexico State's Secretary of Economic Development.

Figure A2.3. Oaxaca: Anticompetitive Regulations in the Retail Sector



Note: This graph reflects all potential regulations that restrict competition (e.g., granting of temporary exclusivity) and classifies them into general and specific categories. In the category "Rules that reinforce dominant positions or limit entry", there are 18 types of restrictive regulations in the transportation sector ("max"). Of these 18, 10 have been found in Oaxaca. **Source:** Authors' elaboration based on the information provided by Oaxaca's Secretary of Economic Development.



Note: This graph is based on the same list of regulations as the one on the left. However, within each category, those restrictions on competition that are more restrictive to competition have been identified (e.g., absolute barriers to entry versus relative barriers) and have been weighted twice as much as those that are less restrictive. The sum of the weighted restrictions is normalized to a value of 0 to 6. Although Oaxaca imposes an equal number of restrictions that facilitate collusion and that discriminate, regulatory barriers in the category "Rules that discriminate and protect vested interests" are the most restrictive. **Source:** Authors' elaboration based on the information provided by Oaxaca's Secretary of Economic Development.

Annex III. The Action Plan for Reforming Cargo Transportation in Tabasco State

The details of the reform action plan agreed to with the Governor of Tabasco State includes:

(i) **The formalization and facilitation of self-transportation and the implementation of an expedited process for granting self-transportation permits.** This will create opportunities for entrepreneurs in Tabasco whose transportation needs are not met by the current operators (unions) by enabling them to satisfy their own demand for transportation services with their own assets and their own capital. [62] Expanded transportation options will promote entrepreneurship and encourage investment in Tabasco.

(ii) **An intensive cargo-transportation supervision campaign.** This will deter illegal practices such as providing unauthorized transportation services, or providing public transportation services using private transportation permits, while ensuring that the rights granted to private permit holders are protected and that the current policy scheme is not affected. In addition to enforcing compliance with the necessary permits and concessions, the supervision campaign will enforce quality, environmental and security requirements.[63]

(iii) **An awareness campaign regarding rights and responsibilities under the Transport Law and the Federal Antitrust Law.** This will ensure that concessionaires do not engage in illegal practices when coordinating their economic decisions and it will allow individual dealers who wish to offer higher-quality services to contract individually with clients and thus expand their businesses. This activity will also increase the level of predictability of the operators in the market, who can now learn more about their rights and obligations and thus ensure compliance with applicable laws. This measure will contribute to the regularization of the market[64].

(iv) **The adaptation of tariff schemes to a rate band, with the currents rates set as a maximum.** This will allow current concessionaries greater flexibility to offer services at better prices by allowing them to offer temporary discounts and promotions within the established rate band. Greater price flexibility will not only strengthen entrepreneurial freedom, but

62 Within this stage, two main actions were proposed: (i) The transportation authority will clarify that the issuance of self-transport services do not affect the rights of the current concessionaires. It will also clarify that the scope of self-transport permits covers the only the activity of transporting goods for satisfying their own needs without offering them to the public, so there will not any interference with the right of the unions; (ii) The transportation authority will grant self- transport permits within 3 working days, after which, if no reply were received, it would be deemed to have been granted. It was suggested that the circular clarifying the aforementioned provisions be published in the official newspaper and in the different government websites. Additionally, the SCT will inform the mainstream media with a press release.

63 The main activity proposed within this stage was the launching of a campaign for combating informality and guaranteeing security in the provision of the service, in coordination with the concessionaires and other interested parties in the cargo transport sector. This campaign will focus on compliance with the appropriate permits and / or concessions as well as the rights granted in each case (for example, preventing private transport permit holders from providing services to third parties). The mainstream media will be informed about the campaign with a press release that will detail the sanctioning measures applicable under the Regulation.

64 One of the findings was that the unions operate as a single decision unit, instead of individual dealers acting as competitors among themselves. Throughout all the 32 federal entities, the federal authorities of economic competition have already detected 9 incidences of illegal and anticompetitive practices in the cargo transport sector.
The mains activity proposed under this stage was to launch an informative seminar –with the participation of officials from both the Federal Commission of Economic Competition (COFECE) and the Secretariat of Transport of the State of Tabasco– where the main provisions of the Mexican Antitrust Law will be presented, specifically in relation to the coordination between Competitive Economic Agents.(explaining that contracts, agreements, arrangements or combinations between individuals – each being individually concessionaries of public transport and competing Economic Agents– is an infraction to the Antitrust Law.

will also benefit consumers of transportation services for cargo and construction materials, including small companies engaged in construction or commerce.[65]

(v) **A declaration of the need for the service based on technical findings.** As mentioned above, under the current regime, the necessity of the service must be proven in order for the state to grant new concessions. Thus, this declaration will allow the expansion of the supply of public cargo and construction material transportation, which has lagged the growth of demand.[66] This action will also be the first step towards regularizing the unauthorized transportation services that currently satisfy the excess demand (for example, transportation via 32m3 gondolas). Recognizing the need for service will allow all market players to compete on a level playing field.

(vi) **The granting of additional permits valid for five years.** This will allow authorized public transportation services providers to meet the excess demand. Although some large operators in the State of Tabasco with sufficient resources to acquire capital will begin offering private transportation service, many smaller firms will benefit from additional public transportation service providers. Finally, these measures will guarantee that all providers of public transportation services for cargo and construction materials compete on equal terms.[67]

(vii) **A comprehensive reform of the Transportation Law.** The authorities will prepare a draft amendment to the Transportation Law of the State of Tabasco based on recommendations from the World Bank Group and CONAMER. The reformed law will include, inter alia, provisions to: (a) replace the concession scheme with a single authorization scheme valid throughout the state and covering all types of cargo and construction materials transportation; (b) establish that this authorization would be granted at the initiative of the private sector following an evaluation of objective characteristics that promote traffic safety and environmental protection; (c) eliminate the requirement to prove the need for new services; (d) establish that transportation service prices will be determined by the market; and (e) eliminate the need for private cargo transportation permits.

65 It was proposed that concessionaires and permit holders were allowed to charge a fee which does not exceed the maximum nor the minimum limits defined by the transportation authority (which will be aligned with the minimum cost of an efficient unit). Nominally, the pre-existing rights of the concessionaires are not affected because they can continue to charge the maximum rate (the maximum limit is not reduced and it could even be increased); nevertheless, they are free to charge an even lower rate.

66 It was proposed that a statement of need will be issued based on the results of the technical studies carried out by the authority, based on these main findings: (i) The volume of material for annual extraction authorized by exceeds the capacity of the vehicles granted by 14 times. That is, demand exceeds supply, even without considering other sources of construction material unaccounted for due to the sedimentation and dragging of rivers and streams. Even in relation to other states in Mexico of similar GDP, the size of the vehicle fleet in Tabasco is still small.

67 A call will be issued for a specific number of permits for public transport of cargo and construction materials based on the declaration of need, in the terms established by Law and Regulations and addressed to all potential interested parties, including concessionaires and permit holders that are providing the service. This will be published in the Official Gazette and in the media.

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