

Institutional policy and economic development in Mexico

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The idea of the present work arises from the fact that the countries of the world are looking every day for the way to turn their productive apparatus more efficient and competitive. In the last years, several countries have limited the participation of the State in the process of allocation of economic resources, nevertheless, it is necessary to mention that the reduction of the this participation of the State has been replaced in the greater measurement by institutional policies in favor of the economic development of the country. Independently of the economic position that occupies a country or a region that consists of the respect to the property rights, the conditions of access to the judicial system for the overcoming of commercial differences, and the mechanisms of creation and application of the laws. In Mexico, I could realize the impact that the Law of foreign investment has had on the development and the growth of the manufacturing sector of the country.

LIE, Investment, SME's, Finances

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Introduction

To comprehend the global economic growth, is not enough to analyze the economic policies of the last decades or the external shocks to which a region or a country has been exposed. It is necessary to go further and consider the persistent factors that have affected the regional economic performance through history, among others geography, natural resources, income distribution, etc. Among the main factors of Latin American economic performance, the role played by institutions in regional economic growth is cited. Hence, the interest in analyzing the impact that this institutional policy has had on the economic development of Mexico. It is noteworthy that one of the objectives of each government is to ensure the welfare of its people, and to achieve this, is important to design policies in an effort to meet these needs through investments, infrastructure, health and protection centers, not to mention more than a few.

In order to assess better the impact of the institutional policy on economic development, this paper is divided into three main sessions. The first one provides a brief review of institutional policy, analyzing the theoretical foundations and their classification. The second session discusses theoretically the concept of economic development and its relationship with institutional policy. In the third session an analysis is done by taking an example of institutional policy (Foreign Investment Law) and its impact on a sector of the economy (manufacturing).

Institutional Policy

The role of the state in the development process has changed substantially in recent decades.

According to the conception of the classical economists that prevailed in the decades of the 50s and 60s, government involvement was predominantly to stimulate the transfer of production factors from traditional sectors with low productivity, low technology and diminishing returns to modern sectors with high-productivity and increasing returns.²⁸ In other words, from agriculture to industry, and from rural areas to urban areas.

Rigidities were observed regarding these transfers: lack of adequate infrastructure, lack of information and lack of market. Therefore, and according to this trend, the market alone could not promote growth and it was necessary the state intervention. In addition to fulfill with its sovereign functions (for example, security, justice, education and health), the State acted in the economic life through the direct control of the production and distribution of a great amount of goods and services. In various countries, the State was also responsible of managing financial institutions, and controlling trade and capital flows between national economy and the whole world²⁹.

The matter of the State has a special attention on the institutions play in order to explain the political or economic results that are studied.

²⁸ Montes-Llamas, G. (2000) "Las reformas institucionales y el desarrollo del sector rural Latinoamericano." Pontificia Universidad Javeriana. Seminario Internacional, Bogota, Colombia. Disponible en la World Wide Web: <http://bibliotecavirtual.clacso.org.ar/ar/libros/rjave/paneles/montes.pdf>

²⁹ N' Diaye, S. (2001). "Importancia de las reformas institucionales: Africa y la Mundializacion" Editorial 18 Finanzas & Desarrollo.

In fact, the institutionalism emerges as a reaction to the theoretical approaches that privilege the individual as responsible for how the systems operate. This states that the set of all existing institutions is what determines the actions of individuals, not vice versa. The persons who try to explain how institutions emerge and evolve are also considered part of the institutionalist current.

In this context “institutions” refers to the rules, application mechanisms and organizations related to economic transactions (World Bank, 2001). Among other elements, institutionality consists then in the respect of the property rights, the condition of access to the judicial systems in order to solve commercial differences, and mechanisms of creation and application of the law.

This varies from country to country, depending on the combination of several factors: the structural factors with specified cultural, political and social dimensions and the cyclical factors which may be relatively transitory.

Theoretical Foundations of Institutional Policy

The historical, sociological and rational choice approaches stand out in the theoretical debate on the origin and institutional change (Hall y Taylor 1996).

The historical institutionalism: it refers to formal and informal proceedings, routines, norms and conventions embedded in the organizational structures of political community or market (as a place). Those institutions are the result of power fights between actors that have higher or lower asymmetry degrees in their access to resources.

In this approach, the ideas and its diffusion also play an important role in the determination of political or economic results.

Moreover, in many cases, those results are consequences not expected by the actor who imposed their institutional arrangements.

Talking about institutional change within this historical framework, it's worth to mention that the institutional stability is applied as a resistance to change, imposed by the institutions themselves who limit the reform options that are available to actors. In fact, different institutional trajectories are explained by inherited past conditions. For example, capabilities of the State into a particular historical moment can affect public policy options at a later time.

Nevertheless, the possibility that some important institutional change occurs always remains open.

The sociological institutionalism: defines institutions as systems of symbols, cognitive maps and moral patterns that provide “frameworks of meaning” to guide the human action. It has a strong cognitive dimension recognizing that the categories and mental models are indispensable for the action / response and for the interpretation / recognition of the world around us.

This approach suggests that the institutions not only condition human behavior but also affect individual preferences and identities. From this point of view, the specifically cultural, organizations adopt new institutions when they increase the social legitimacy of these, according to what is considered socially appropriate.

The rational choice institutionalism: is the most influent in the northamerican academy and defines institutions as those arrangements that provide certainty, information, facilitate coordination and, consequently reduce transaction costs.

Society finds in them mechanisms that give structure to the individuals' options, who at the same time act as rational agents analyzing the cost/benefit and behaving strategically to maximize their welfare. For rationalists, the strategic interaction is what determines the political or economic outcomes, and institutions are the result of a voluntary agreement between relevant actors, in contrast to the historical approach. Existing institutions are the product of a competitive selection process where only those that offer more benefits to society may persist.

Concluding, we can say that irrespective of the countries, which could be emerging or advanced, the institutions are based on many theories, in other words, the previously cited approaches are in the institutional policy of a country.

Classification of institutional policy

There are different types of institutions according to its formalization in law (Ayala, 2001), its level of hierarchy (Williamson, 2000) and its analysis area. From this perspective, Ayala (2001) classifies them in: formal institutions and informal institutions.

He includes those institutions that represent rules written in the laws and regulations expressly created by individuals to address specific problems of economic, social and politic coordination in the first group.

It also notes that the implementation and enforcement of these is mandatory requiring coercive power for their enforcement so these institutions are referred to the field of public order. On the other hand, he refers to informal institutions as those unwritten rules that accumulate over time and are part of the so-called customs and traditions.

Both high-icome and low-income countries lie on informal institutions, mainly, to facilitate transactions. However, these institutions are relatively more important in poor countries where formal institutions are less developed.

Besides, poor people in developed countries have often limited availability to formal institutions. Meanwhile Williamson (2000) propose a classification based on different inheritance levels with an alternative to the classification along the formality of institutions.

Level	Example	Change frequency	Effect
Institutions related to the social structure of a society (Level 1)	mainly informal institutions like traditions, social norms. exogenous.	too long horizons (from 100 to 1000 years) but that may change in time of crisis or stock	defines how the society conducts themselves
institutions related to the game rules	mainly formal regulations, that define property rights and juridic system. exogenous and endogenous	long term horizon (from 10 to 100 years)	defines the global institutional environment
institutions related to the game (level 3)	definition of government rules to the private structures of a country and contractual relationships, for example, contracts, agreements. Exogenous.	medium term horizon (from 1 to 10 years)	leads to the construction of organizations
institutions related to the assignment of mechanisms (level 4)	rules related to resource allocation. p / e control of capital flows, trade regimes and social security systems	short term and continuous horizon	Product and price adjustment agreements and incentives

Chart 1 Classification of institutions according to hierarchies

Source: Jütting based on Williamson, (2000)

The different levels of institutions are presented in the table above and more than exclusives they are interconnected.

Higher levels impose restrictions on lower levels and there is a feedback from the lowest to the highest levels.

According to the last approach, literature classifies institutions according to the differences among various analysis areas. The 4 categories more used in literature are:

Economic institutions: authors normally give rise to the rules that define the production, allocation and distribution of goods and services, including markets (Bowles, 1998).

Political institutions: studies of political institutions usually employ variables that detail elections, electoral rules, types of political system, composition of the opposition and government parties, control, balance and political stability measures. (Beck et al, 2002).

Legal institutions: Studies related to laws and institutions refer to the type of legal systems, the definition and implementation of property and inheritance rights.

Social institutions: they are focused on the access to health, education and social insurance agreements, and they have impact on gender equity and how to govern, more generally, the relation between economic actors.

As mentioned, a diversity of opinion is noted with respect to the classification of institutions. The following section relates theoretically institutional policy and economic development.

Institutional policy and economic development

According to the typology developed by Dani Rodrik and Arvind Subramanian³⁰, the scope of the analysis of institutions is wide, this includes market-making institutions that safeguard property rights, legitimation of market institutions that provide social assistance and insurance, organize redistribution and manage conflict, and institutions that regulate and stabilize the market.

This analysis scope is obviously very important and recent empirical studies support the theory developed in particular by Douglass North, winner of a Nobel Prize in economics, which says that institutions are vital to economic development and differences in their quality contributes to the explanation of development voids due to its effect on the operation of markets. Regarding the product market, determines the degree of competitive pressure and innovation efforts.

The labor markets influence the reorganizations as well as income and outcomes. They have an impact on capital allocation and funding of investment and development.

Therefore, is not surprising that the role of institutions is prominent in the analysis of the causes of the financial crisis and its high cost in terms of economic development and of the lessons being drawn from recent disruptions in the financial system

³⁰ Subramanian, A; Rodrik, D. (2009). "Instituciones y Desarrollo Economico" Peterson Institute for International economics.

The Inter-American Development Bank, in an econometric evaluation, points out that 60% of the income gap between Latin American countries and developed countries is attributable to the quality of the institutional structure (BID, 2000). The importance of this factor is even greater when compared with the situation in Southeast Asia since it is the cause of up to 80% of the difference in terms of income. The institution with the highest governance can explain the high rates of economic development as mentioned by Kaufmann, Kraay and Mastruzzi (2003).

Several authors have analyzed the influence of political and property rights in economic growth in many countries and have concluded that the respect for the law has a significant effect on the average income and the income of the poorest 20% of the population, while political participation seems not to influence mainly on the income (Dollar and Kraay 2000). The previous conclusion is limited, since in a good democratic system, administrative responsibility can be controlled by voters, corruption could be reduced, public function could be improved, and therefore, economic growth may occur. (Adserá, Boix y Payne, 2003).

The quality of the institutional structure may also affect social conflicts. Rodrik notes a relationship between external shocks, social conflict and development. By the way, when external shocks that usually affect some sectors and favor other occur, the existence of a weak institutional structure does not allow handling conflict from the benefits distribution, which leads to possibly postpone the necessary programs to face the situation, including fiscal adjustment or a depreciation of the real exchange rate (Rodrik, 1999 y Gaviria y otros, 2000).

In regard to the labor market, it is generally recognized that rigid institutions have a negative long-term impact. However, in the short term, strong rigidities in redundancy rules cause a decrease in employment and consequently a small increase in unemployment when economic conditions deteriorate³¹.

In this regard, Djankov and others. (2002) state that the deficiency of quality of institutional structure and economic development are the effects of excessive bureaucracy, discretionary power and corruption (It's a serious problem that affects the legitimacy of the system and even the viability of the democratic regime) produced in the size of the informal sector.

Some studies reveal, in regard to the magnitude of the informal sector, that their main determinants are discretion in tax policy, labor market regulations and public sector efficiency³².

³¹ Noyer, C. (2009), "Challenges and strategies for promoting economic growth" Institutional Arrangements and Economic Growth, Mexico.

³² Johnson, S; Kaufmann, D; y Zoido L.P. (1998) "Regulatory Discretion and the unofficial economy. The American Economic Review, Vol 88 No.2, pp.387-392.

Loayza, N. (1997). "The economics of the informal Economic" Policy Research Working Paper Series 1727, The World Bank, Washington DC.

Institutional Policy on the Economic Development: example of the law of foreign direct investment in the development of the manufacturing sector.

The liberalization process in Mexico has gone through many stages that began with the Industrialization Model through Import Substitution (ISI for its acronym in Spanish), to later reach the signatures of the Free Trade Agreements (FTA) that began with Mexico's entry into the World Trade Organization (WTO) going through the different foreign investment laws, which will open the doors to the outside world. During this session, the impact of institutional policies in favour of foreign investment law on the economic development of manufacturing sector will be analyzed.

The regulatory framework: Foreign Investment law.

The history of Mexican economic liberalization has been affected by the adoption of institutional policies through the publication of two laws on foreign investment.

One component of the process of economic globalization is the FDI, the possibilities it creates for the various economies are numerous: internationalization of the domestic economy, creation of jobs, exposure to new ideas, technologies and work practices that can be set in the host country of investment, are just some of the advantages offered (Ramírez; 2002). Thus, his decision is the result of a complex process that differs in many aspects from the decisions that determine the decision to investment locally.

Unlike indirect foreign investment that is a portfolio investment, FDI is when a company located in a country makes a direct investment in the market for a third either acquiring an existing company in the market or otherwise proceeding to create a new entity. Williamson (1990) states that an attitude that limits the entry of FDI is considered irrational. Such investments can provide necessary capital, technology and expertise, either producing necessary goods for the domestic market or contributing to new exports. The acquisition of technology and its diffusion promotes productivity growth.

Many countries have adopted policies for attracting foreign investment. Mexico has not been left behind in this process, adopting two laws that have profoundly affected the entire economy in general and the manufacturing sector in particular

The first law called "Law to Promote Mexican Investment and Regulate Foreign Investment" was published on March 9, 1973 in the Official Gazette (DOF for its acronym in Spanish). Twenty years later, this law is reformulated and called foreign investment law, and is published in th DOF on December 27, 1993. The latter has undergone amendments by the decrees published in the Official Gazette on May 12, 1995, June 17, 1995, December 24, 1996, the 23 January 1998, 19 January 999 and June 4, 2001.

The regulations of the Foreign Investment Law (LIE for its acronym in Spanish) and the National Registry of Foreign Investment is specified by the dispositions of the law published in the Official Gazette on September 8, 1998.

The 1973 law, of public interest and general enforcement in the Republic, had the objective of promoting Mexican investment and regulate foreign investment to encourage fair and balanced development and strengthen economic independence.

When comparing the two laws, it can be said that their difference lies in the fact that the LIE of 1993 eliminates sectoral restrictions and performance requirements, except for reserved activities, contained by the Law to Promote Mexican Investment and Regulate Foreign Investment of 1973. Gomez and Aguilar (2005) mention that the law of 1993 is a law aligned with the Washington consensus to deregulate and allow the freest possible market functioning and that allowed the entry of goods and services and capital from abroad to the capital flow. Capital flows from abroad has affected economic development in all sectors, some more than others, like in the case of the manufacturing sector.

Mexican manufacturing sector

The manufacturing sector in Mexico is considered as the main engine of economic growth and industrial development of the country so it is valuable to present briefly the manufacturing sector and its contribution to national economic development. This national economic development can be assessed in terms of productivity or growth. In recent year the industrial and foreign trade policies in Mexico have been focused on the promotion of manufacturing exportation due to the importance that this sector has on the economy. Because of this, other variables were altered: demand (consumption, gross fixed capital formation (GFCF), exports), supply (production, imports), the productive structure, employment and productivity in this sector.

In the early eighties, the change generated favorable results, but as time went by, especially with the entry into force of NAFTA, a decoupling between industrial policy and the actual situation of the sector is presented, observing an industrial policy that lacks of goals and strategies that meet the needs of the labor process of industry in Mexico, in every region of the country. The economic policy of the country has left behind the sector with a lag between main macroeconomic variables and requirements of this industry to the sectoral and regional levels. Despite this, the manufacturing sector has not lost its place in the national economic development.

In the next paragraphs the contribution of this sector is analyzed to Mexican economic growth 1980-2005 in order to see their evolution over the past 25 years, emphasizing the following variables: The Gross Domestic Product (GDP), imports, exports and employment. This time frame was chosen in order to observe and analyze the behavior of FDI flows before and after the second reform of the foreign investment law.

The share of manufacturing to GDP represents an average of 18%, which is still very relevant considering that this is a single sector. The variation of the annual averages of manufacturing GDP over 25 years reveals that this variation reached its lowest point in 1983 with -8.42% and then grow to its highest point in 1996 that is, three years after the second reform of the foreign investment law.

Talking about employment in this sector, labor productivity has been improved compared to the number of persons employed in the same sector. From 1980 to 2006, labor productivity has always been higher, except for the years 1980 to 1982 and from 1997 to 1998.

Finally, in terms of analysis on exports and imports of Mexican manufacturing, percentage changes in the annual averages show a trade balance surplus during the periods of 1982-1985, 1986-1988 and from 1994 to 1997. The results of a study by Tomta (2009) revealed the presence of a technological spill in terms of increased labor productivity in the manufacturing sector because of FDI flows entering Mexico through TNCs.

From the above it is clear that a country or region that has its institutional policies well-established according to the needs of its citizens is undoubtedly a successful country.

Conclusion

There are many persistent factors affecting regional economic performance throughout its history, including geography, natural resources, income distribution, etc. Institutions are postulated as one of these factors; hence the State has placed special emphasis on the role of institutions in explaining the political and economic outcomes that are studied. In fact, institutionalism emerges as a reaction to the theoretical approaches that emphasize the individual as responsible for the way the systems operate. Regardless the economic level of a country, the institutionalism consists on the respect for property rights, the conditions of access to the judicial system in order to overcome trade disputes, and the mechanisms of creation and application of the law.

The application of good corporate policies are accompanied by good economic development, development that affects all areas of economy, with better jobs, higher standards of living of the population, better infrastructure accompanied by new technologies that allow the companies to gain competitive advantage.

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