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I. INTRODUCTION

Under the old Mexican protectionist model the commercial barriers were aimed at substituting imports for domestic production and foreign investors were not supposed to distress local entrepreneurs. Moreover, the intervention of the Government in the economy through state-owned enterprises, direct financing, and subsidies was quite far-reaching. The model was very successful for a while—Mexico accomplished sustained growth from 1952 to 1970—but its improper prolongation began to deteriorate public finances as well as the productivity and competitiveness of the domestic industry. The first Foreign Investment Law, enacted in 1973, still reflected a restrictive approach towards internationalization, as foreign capital faced several entry and operational restrictions.

The strategy of economic opening and liberalization implemented in the early 1980s and intensified in the early 1990s changed things dramatically. Exports and Foreign Direct Investment ("FDI") became major drivers of growth. The North America Free Trade Agreement ("NAFTA") entered into force in January 1, 1994 only a week after the enactment of the new Foreign Investment Law that, as opposed to the 1973 Law, established—for that time—a quite liberal and promotional regime for foreign investors.

II. FDI'S ADVANTAGES FOR HOST ECONOMIES

Literature has extensively documented the benefits that FDI may bring to the host economy. These include: i) the generation of employment, most likely to be well-compensated as well as the encouragement of human capital formation; ii) the creation of forward and backward linkages; iii) the transfer of technology and know-how; iv) the increase of exports through the activity of multinational enterprises; and v) the strengthening of the host country's external accounts and tax base.

However, FDI benefits vary according to the type of investment, whether resource, market, or efficiency-seeking. But mostly, these benefits are contingent on the specific national institutional, economic, and competitive settings, as countries have different "absorption capacities." Along with good FDI policy, countries should also maximize benefits and minimize costs through the implementation of smart public policies in the context of an overall strategy for sustainable development and inclusive growth.

Mexico has witnessed important benefits from FDI, both quantitative and qualitative. The country has multiplied its FDI inflows since the new regime. While it was receiving $2.5 billion annually between 1980 and 1993, it got nearly $15 billion between 1994-2002 and $23 billion

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between 2003 and 2011. But the most encouraging fact is that these amounts of capital have been channeled to sectors that have had a tremendous positive impact in the economy.

The most preferred sectors for foreign investors since 1994—manufacturing, financial services, retail, media, and business-support services—have contributed 43.8 percent of the gross national product ("GDP") in this period. Manufacturing alone—which tends to produce greater benefits in terms of aggregate production and employment—has attracted 45.3 percent of all FDI and contributed 18.9 percent of GDP (the ten favorite manufacturing activities representing 72.5 percent of the total employment in manufacturing). Sub-sectors of great added value include the automotive, aerospace, electrics, and electronics industries. Mexico is currently a superpower exporting-country (15th place among 186 according to the WTO), mainly thanks to FDI-driven exporting industries.

FDI has also lived harmoniously with domestic capital, as the latter is, by far, more important than the former. As a percentage of the gross fixed capital formation, FDI in Mexico has averaged only 12.2 percent in the last two decades. This means that nationals have taken most investment decisions. This is a good thing because FDI should be a complement of, not a substitute for, domestic capital. In general, a "crowding-in" effect has prevailed; that is, FDI has not displaced local industries, but created and developed new ones.

III. MEXICO'S ISSUES WITH FDI

However, after almost two decades after the enactment of the Foreign Investment Law, and despite all the liberalization efforts since then, there remains a striking fact: Mexico is one of the most restrictive economies towards FDI in the world. According to the "FDI Restrictiveness Index" of the OECD, Mexico is the eighth most restrictive economy among 55 countries. Where 1 means total restriction and 0 total openness, Mexico obtains a coefficient of 0.224 (OECD average being 0.083 and non-OECD average being 0.140).

Likewise, according to the World Bank study "Investing Across Borders," Mexico appears, together with Bolivia and Haiti, as the most restrictive economy in Latin America. These indicators do not take into account the possibility of "neutral investment" recognized in the Foreign Investment Law, by means of which FDI—with prior authorization—may participate in restricted or regulated sectors above the established limits through special shares or equity instruments that confer limited voting rights. This may change the referred indicators but does not change the fact that the regime remains strict under international standards.

This strictness is due to the fact that the Foreign Investment Law contains a significant list of economic activities that are reserved for Mexican nationals or for Mexican enterprises fully-owned by Mexican nationals, as well as others which are subject to specific equity caps (of 10 percent, 25 percent, and 49 percent). These restrictions mainly apply to the services sector, namely broadcasting, telecommunications, energy, financial services, and transport by road, air, and sea. The foregoing is in addition to the activities that are exclusively reserved to the Mexican State by virtue of the Political Constitution, such as the generation and distribution of electricity and the oil industry's upstream and downstream activities.

So Mexico is not as open as many would assume. This, of course, comes with a cost. In the first place there is a cost of opportunity in terms of lost investment that would have arrived had the restrictions not been in place. Actually, the OECD has estimated that if Mexico lowered its restrictions to the level of the most open country of such group, its FDI inflows could increase up to 50 percent. It is difficult to assess the seriousness of such an estimate, but what we do know from experience is that when we have opened up attractive sectors, FDI has gone up. Recently, other countries such as Brazil and India have experienced the same result.

IV. FDI POTENTIAL IN MEXICO

During recent years FDI inflows have stabilized between $20 and $22 billion, a long way from the Mexican economy's potential. The commercial policies that have stimulated FDI since 1994 have been (naturally) losing their effect. Domestic reform is needed for another long-term boost. Mexico captures most of its FDI in manufacturing while the world captures most of its FDI in services. Therefore, there is a great potential to heighten Mexico's number.

There is another potential benefit of greater impact. Most FDI restrictions apply to highly concentrated and regulated services, which have significant barriers of entry (regulatory and non-regulatory) and operate under poor competition conditions. Hence, it is not a surprise that the services sector in Mexico is not as big and dynamic as it should be. This circumstance is, of course, associated with the weak competition conditions prevailing in key sectors.

In terms of quality, prices, supply, consumer options, innovation, level of investment, and the availability and adequacy of infrastructure, this situation is highly prejudicial to the welfare of people, the competitiveness of enterprises, and the economy in general. As a matter of public policy it is imperative to question the economic rationale of prevailing FDI restrictions. Any barrier of entry that does not accomplish a specific objective of public interest—having benefits superior to costs—must be wiped out or at least relaxed.

Another of FDI's advantages is that it may effectively foster competition when a foreign player—with technical capacity and financial power—enters into a highly concentrated market dominated by one or a few domestic firms. Let's review briefly some cases.

A. Broadcasting (Reserved For Mexican Nationals)

There are only five national channels for more than 113 million Mexicans, of whom almost 95 percent have access to over-the-air television. Two incumbent companies alone have especially strong concentrations—95 percent of television concessions, 99 percent of income from television advertising, and 98 percent of the audience. FDI's participation, by itself or together with national investors, may foster competition, reduce advertising costs, increase the distribution channels for independent producers, and foster diversity and plurality. It would also strengthen the potential benefits from the government's current attempts to bid spectrums for television services, turn off analog signals, and transition to digital broadcasting.

B. Telecommunications (49 Percent Cap)

Mexico is one of the very few countries in the world (certainly the only one in the OECD and Latin America) that restricts the participation of FDI to 49 percent in the telecommunications and satellite industries. This restriction encompasses a large number of services, the most relevant being fixed-line telephony, restricted television (whether supplied by satellite or cable), internet, and broadband. This inhibits investments and, consequently, the development of infrastructure. The telecommunications sector in Mexico shows high levels of concentration together with extraordinary profit margins obtained by the incumbent agent, which, according to the latest OECD figures, accounts for 79.6 percent of the telephony fixed lines, 70 percent of the mobile lines, and 74 percent of the fixed-lined internet subscribers.

There are several other facts that call for greater FDI participation: the penetration of fixed-lined telephony services has remained stagnant for more than a decade; despite a significant increase of internet users (particularly broadband) and restricted television subscribers in recent years, Mexico is still far away from the penetration levels of other countries; Mexico is the country with the lowest level of investment *per capita* in the sector within the OECD group; and, finally, tariffs that do not look bad internationally when compared in dollars look very bad when compared in PPP dollars ("Purchasing Power Parity").

It is worth noting that, solely with respect to mobile telephony services, FDI may participate up to 100 percent with the prior approval of the National Commission on Foreign Investment. This regulatory asymmetry is absurd in the context of the convergence era and impedes the efficient integration of related and complementary services. Naturally, operators invest with the idea of providing all services that are technologically capable of being offered by their infrastructure and networks.

C. National Air Transport (25 Percent Cap)

In Mexico, thanks to the incursion of various low-cost airlines, the market has developed quite satisfactorily and is now much less concentrated than it used to be. However, airfares still greatly depend on the specific national route; a route where several airlines compete throws reasonable airfares, whereas a route served by one or two airlines shows unreasonable and artificial airfares. Airfares are also extremely sensitive to the exit of airlines (10 of them, including *Mexicana de Aviación*, have left the market between 2007 and 2010, in many cases for financial reasons). More FDI would allow established airlines to have easier access to capital and facilitate the entry of agents (by themselves or through strategic alliances with nationals), heightening supply and pushing down prices.

It is worth highlighting here that other segments of transport also face FDI limitations: national road transport is reserved to Mexican nationals and maritime cabotage is subject to a 49 percent cap.

D. Distribution of Liquefied Petroleum Gas ("LPG") (Reserved For Mexican Nationals)

A small group of domestic companies dominate the national market, with levels of concentration depending on each relevant market. It is also notorious that distribution equipment is—in general—obsolete and inadequate. Given that the final consumer price of LPG is fixed by the Government, only big distributors are able to develop the necessary economies of scale to generate profits. This restriction may also produce incentives to maximize rents through illicit conduct, including fraudulent and monopolistic practices. More FDI could generate positive competitiveness pressure and facilitate access to capital in order to allow small groups to compete more effectively against bigger agents and to deploy more and better infrastructure. It is worth mentioning that all downstream activities related to natural gas are open to FDI, as is also the case for LPG transportation and storage.

V. CONCLUSION

Traditional arguments to justify FDI restrictions relate mainly to sovereignty, national security, and protection of domestic industries. Nowadays, in most cases, these explanations are difficult to sustain. Modern states may accomplish critical public objectives—more effectively and without incurring severe opportunity costs—through other means such as strong and well-designed regulation. These objectives may include (i) safeguarding the social function of television, (ii) a competitive setting for the supply of broadcasting and telecommunication services, (iii) operational security when it comes to transport, (iv) the stability, integrity, and soundness of the financial system, (v) the rights of consumers, and (v) the integrity and functionality of the markets. Origin of capital is irrelevant in achieving any of these outcomes.

Arguments for the protection of a domestic industry should, in any case, refer to infant industries that have a real potential for growth. Overall, this tool belongs to an economic model that has been dropped by most countries. But in Mexico we are talking—in most cases—about highly concentrated markets dominated by one or a few national firms. Any accusation of a crowding-out effect is unrealistic(in any case, the substitution of one inefficient agent by one efficient agent would do a great favor to the economy and consumers). The only possible effect here of a more progressive regime would be a boost to competition in favor of consumers.

Further, lifting or relaxing certain barriers to FDI in certain critical services would attract more FDI inflows, foster competition, improve overall productivity, and facilitate access to financing. It would also improve existing infrastructure, reduce costs and heighten the quality of the inputs required by the manufacturing sector, and strengthen Mexico's logistic and export industries.

An ample base of service suppliers operating in a competitive scenario is critical at this stage of Mexico's development. Continued development is, of course, contingent on a large array of factors, mainly of an economic and institutional nature. A friendlier and more open FDI entry regime is therefore one of many elements. But it would be a step in the right direction that could create both a positive effect by itself and increase the competitive potential of future measures and reforms.