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Think Globally, Act Locally: Decentralized Incentive Framework for Mexico's Private Sector Development

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Volume I
Main Conclusions and Recommendations

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MAIN ABBREVIATIONS AND ACRONYMS

ADAE	Acuerdo para la Desregulación de la Actividad Empresarial
BANCOMEXT	Banco Nacional de Comercio Exterior
CADELEC	Cadena Productiva de la Electronica
CANACINTRA	Camara Nacional de la Industria de Transformación
CEDE	Centro para el Desarrollo Empresarial
CEDECE	Comisión Estatal de Desarrollo Economico y Comercio Exterior
CETRO-CRECE	Regional Centres for Entrepreneural Competitiveness
CICEJ	Shoe Chamber in Jalisco
CND	Consejo Nacional de Desregulación
COMPEX	Export Promotion Mixed Comission
COMPITE	Committee for Productivity and Technological Innovation
CONACYT	Consejo Nacional de Ciencia y Tecnología
CONCAMIN	National Confederation of Industry Assoc.
FDI	Foreign direct Investment
FUNTEC	Fundación para la Innovación Tecnológica de las MyPes
HP	Hewlett Packard
IDEFT	Instituto de Formación para el trabajo
INEGI	Instituto Nacional de Estadistica, Geografía e Informática
ISI	Import Substitution Industrialization
ITESM	Monterrey Institute of Technology
ITESO	Instituto Tecnológico de Estudios Superiores de Occidente
MIPO	Mexican International Procurement Operation
NAFIN	Nacional Financiera
NAFTA	North American Free Trade Agreement ¿????????
NGO	Non-government Organization
PAFIs	Financial Action and Investment Plan
PIU	Project Implementation Unit
PSD	Private Sector Development
SECOFI	Secretaría de Economía
SEMARNAP	Instituto Nacional de Ecología
SEPROE	Secretaria de Promocion Economica
SEPROE	Secretaría de Promoción Económica
SME	Small and Medium Enterprises
TELMEX	Telefonos de Mexico
TI	Texas Instruments
UDE	Unidad de Desregulación Económica
UNDP	United Nations Development Program
USI	Universal Scientific Industrial Company

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Decentralized Incentive Framework for Mexico's Private Sector Development

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Think Globally, Act Locally:
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Part I - Main Conclusions and Recommendations

Main question of the study

The central question of this report concerns the facilitation of public good – efficient institutions of private service delivery benefiting firms of all sizes, but particularly SMEs. We will show that such institutions are best off created at the state and regional level and then scaled to the national level. This second-generation institutional agenda is at the center of a new decentralized system of private sector development to be discussed in this report. Mexico has many highly centralized programs of enterprise development. The challenge is to transform the current centralized system of promotion putting states and private sector leaders in the driver seats. Institutional innovation happens on the periphery and away from the center: this reinforces the need to construct a new system of promotion around bottom-up initiatives of states and private actors.

A new system of industrial promotion will still require Federal involvement but functions of Federal government will change from direct financing to facilitation, monitoring and evaluation of sub-national private-public initiatives. To capture regional diversity, the new system can be introduced on a pilot basis in two states – one in the Center-North of Mexico and one in the South. With accumulation of experience at the state and federal level, the new system can be rolled out to other states of Mexico.

Objective and audience for the study

Second generation PSD agenda

Following economic liberalization, Mexico was extraordinarily successful in attracting FDI and generating export growth driven by large domestic conglomerates and multinationals. But this growth is very unevenly distributed between regions, sectors and economic agents. The gap between the strong and the weak — North Central and the south of Mexico, large firms and micro-small and medium-sized enterprises (SMEs), exporters and non-exporters does not diminish. This report is about second generation PSD agenda – the facilitation of business environment and learning for weaker agents not yet fully benefiting from economic liberalization: small-scale enterprise, lagging regions, and non-exporters.

Know-how of the second generation agenda

Local private-public partnerships resulting in innovative programs to unleash private dynamism are at the center of this second-generation agenda. A new figure of public entrepreneur – a performance-driven public official designing and implementing innovative solutions and accountable for outcomes – is at the center of the second generation PSD reform. The private sector agents, in particular those in economically lagging regions, is mired in a myriad of constraints. Unlocking these intractable constraints often proceeds by bootstrapping – through the process of incremental bottom-up change in which a favorable balance of risks and returns encourage first steps from many diverse entry points, and each move unlocks the virtuous spiral of institutional reforms and private sector development. Since the report documents how this bottom-up change emerges, evolves, and expands, its story-telling style is somewhat unusual for World Bank reporting. This report argues that determination and implementation of local PSD agenda – of what needs to be done and in which sequence — is better left to local champions from the private and public sector, with the Federal government playing a facilitating role.

Informal group of champions

This report itself is a product of an informal working group of champions from the public sector (secretaries of economic development of Jalisco and Zacatecas, high-level public officials of Secretary of Economy and NAFIN), and SME entrepreneurs. The World Bank team acted as a knowledge broker: it provided conceptual framework for the discussions of this working group and supplied world-wide lessons of the successes and failures of decentralized private sector development. Consultations within the working group revealed that there is little value added in discussing the list of constraints on PSD (which are fairly well known). The champions asked for know-how of local and federal actions to help to alleviate PSD constraints.

Audience for the report

Public sector champions from the federal and local governments and private sector leaders are the main audience for the report. The secondary audience are donors (international development organizations, foundations) and academic policy observers whose job is to offer financial and technical support to private and public entrepreneurs. Promotion of institutions of private sector development is a difficult conundrum for international financial organizations (World Bank, IDB). The fact that their projects do not bring any additional funds to relevant federal agencies depresses *demand* for projects. The fact that promotion of local bottom-up institutional development is design- and implementation-intensive depresses *supply* of relevant projects. The report sheds light on emerging solutions to this conundrum.

Objective of the report

The report focuses on an incentive framework to encourage private sector restructuring and learning. To avoid misinterpretation, let us clarify what this report is **not** about. This report is not about regional development and its determinants. We reject traditional regional development policies based on distortion of relative prices. Nor do we attempt to produce a comprehensive assessment of constraints on Mexico's private sector development. Deficiencies in the legal system, regulatory framework, and physical infrastructure, as well as problems with access to financial resources are well known both to the government and private sector. The report asks **how** the multitude of constraints on private sector development can be addressed through a concerted effort of private and public actors. Our first broad question is about a desirable decentralized incentive framework which would encourage stakeholders to engage in joint problem-solving and reforms. Our second question is about a pragmatic incremental strategy to introduce the new framework which would take into account the vast diversity of capabilities of private sector agents and sub-national governments.

Main questions and messages of the study

1. Why second-generation PSD agenda?

Resolving Mexico's Growth Paradox

During the mid 1980's, Mexico experienced a radical change in its strategy of economic development. It abandoned the policies of import substitution and active Federal government involvement in the management of the micro-economy. In their place, it opened the economy to international competition and trade and moved toward increasing reliance on market mechanisms to allocate resources internally. As a result, maquilas, foreign direct investment, and some very successful national companies have generated significant growth and prosperity. But the prosperity has been very unevenly distributed geographically and across segments of the economy. And, most ominously for the future, successful firms – whether foreign or nationally owned– have cut themselves off from the rest of the Mexican economy. They are attaching themselves to the global economy, relying heavily on imports and foreign suppliers and /or internally performing operations that in other countries firms generally purchase from other enterprises in the locality. The successful firms have in this way become self-contained islands of efficiency within a larger Mexican economy which is very slow to learn how to meet international standards of quality, reliability, and efficiency.

Second generation PSD agenda

The Mexican economy is suffering from a distorted and incomplete adjustment to economic liberalization. The withdrawal of the Federal government left a vacuum of intermediary organizations that connected firms to each other through the social and institutional structures of civil society, and a deficit in the institutional infrastructure. A new tissue of inter-firm relationships has failed to emerge in a timely fashion. These would be service providers such as design bureaus, credit rating organizations, and other business development services typical of mature information-rich markets. The challenge is to initiate institutional development at the local and national level which encourages transition from inward-looking firms, narrow search routines, and information-poor markets to learning-oriented firms and mature, information-rich markets. Public interventions encouraging this transition are beneficial to all and are called horizontal industrial policies (as opposed to vertical policies which pick 'winners').

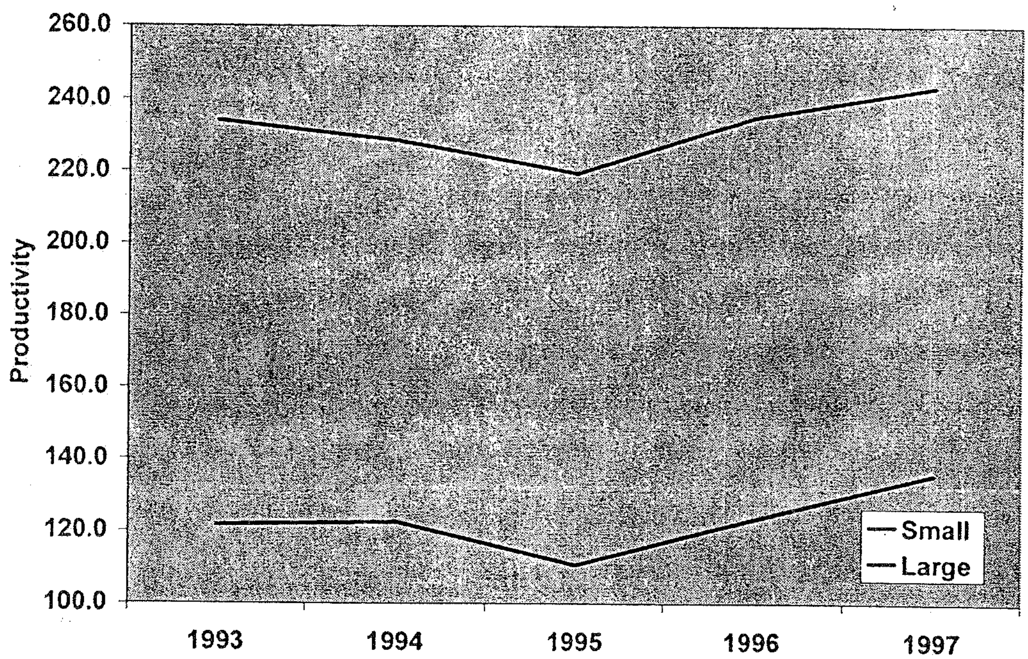
Dual economy

There are two highly disparate economies in Mexico, with traditional sectors such as agriculture stagnating, and others, such as services—which now account for 47.3 percent of GDP—growing strongly. The Mexican private sector has a **bifurcated structure** in which large internationally competitive firms, located mostly in North Central Mexico, coexist with largely domestically oriented and often non-competitive SMEs, with limited linkages between these two sectors (Fig. 1).

Concentration of export-led growth in few firms

Manufacturing is the most important productive sector and the main source of exports accounting for 89.4 % of the total in 1999. Over half of the total, 52.2 % was produced in *maquiladoras*. Although the country has experienced a boom in trade (double that of five years ago), the export base has remained rather narrow and concentrated in a few larger firms. Furthermore, the Mexican export sector remains very dependent on imports of intermediate and capital goods. Mexican firms supply only 4 percent of inputs to the export sector.

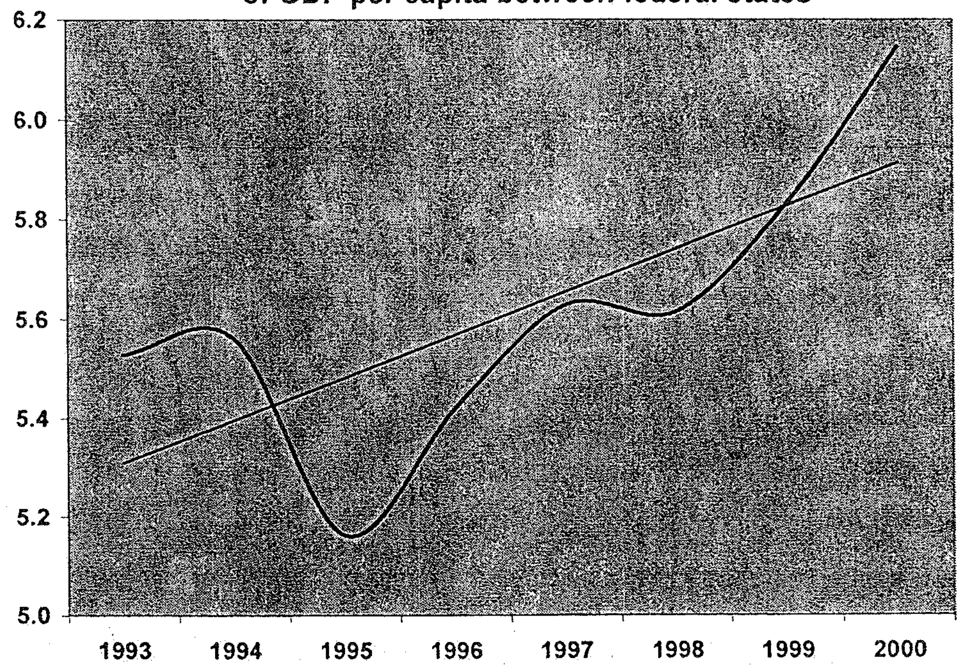
Fig. 1 Dynamics of labor productivity of large firms vs. SMEs



Increasing regional growth inequalities

After World War II, the policy focus on import substitution was based on vertical integration. One location was enough to maintain the main market of the economy, creating what can be called a mega-city industry complex around Mexico City and causing the growth of metropolitan Guadalajara as well as Monterrey. With economic liberalization of the late 1980's, the multiple location system brought in a new dynamic and opened the space to a new agglomeration stage. Agglomeration economies and economies of scale increased in the new locations, affecting GDP inequalities among regions, pushing the ratio upwards once again, and expanding 6.1 times by 2000. Fig. 2 demonstrates that the gap between the wealthiest Mexican states (mostly located at the North Central Mexico) and poor states with dormant private dynamism (mostly in the South-East) continues to grow.

Figure 2. Ratio beween the highest and smallest values of GDP per capita between federal states



Mexico's growth paradox

An increasingly dual economy, the concentration of export-driven growth in few firms, and regional gaps in private sector dynamism is seen both as a problem and an opportunity. But these gaps present an opportunity for action, an opportunity which innovative local private-public partnerships started to take advantage of. This is the Mexican growth paradox: extraordinary dynamism of string economic agents, dormant dynamism of weak agents and states, and opportunity for the weak to catch up with the strong. Where innovative private-public partnerships pushed for a better business environment this opportunity is becoming a reality, but in many Mexican localities the private dynamism is still dormant and untapped.

Emerging solution: promising private-public initiatives

In recent years, however, several Mexican states have moved aggressively to address these problems and capture the opportunities. They have done so by initiating a broad based discussion within the community at large about the economy. Out of this discussion, a process of *innovative private-public problem solving* has emerged. The process has led to a series of imaginative and innovative private-sector led programs focused on the creation of new inter-firm relationships. These programs, combined with on-going discussion out of which they emerged, have begun to rebuild the connective tissue of social and institutional relationships within Mexico itself. They promise over time to reattach the lead enterprises to the rest of the economy through supplier development. They have also begun to reinvigorate traditional industries through horizontal associations and strategic alliances among small and medium size enterprises. Through these alliances these traditional firms are moving to recapture the domestic market and the platform from which domestic demand provides, moving into niche markets within the global economy.

Opportunity captured: example of a pilot supplier development program

In 1999, Nafin, UNDP, and private companies developed a pilot program involving five large domestic firms and their strategic suppliers – 24 SMEs. Opportunities for low-cost improvements were so abundant that in slightly more than one year significant gains were achieved both for small suppliers and the large buying companies. The pilot group of SMEs recorded 46% increase in labor productivity, 26% reduction of inventories, and 10% cost reduction; while large buying companies reduced the payment period to small companies by 75% and increased productivity of the purchasing departments by 30%. The thrust of the methodology is coordinated private-sector driven provision of technical assistance (ranging from simple auto-diagnostics to ISO9000/ ISO14000 certification) and capacity building for small suppliers. To achieve these gains, buyers and suppliers relied upon and adapted to their own needs the full range of existing SME assistance programs. Hence, a properly designed supplier development program would provide a powerful impetus to redesign the whole Mexican system of enterprise support.

Unleashing private dynamism

The central task in the effort to restore balance to the Mexican economy is to broaden and strengthen the developments already underway in the leading states. These developments need to be broadened by extending innovative private-public partnerships to other states, especially in the South where it has not yet begun. These developments need to be strengthened by creating processes of evaluation and continuing improvement for the new programmatic approaches which have begun to emerge, and for systematic innovation, experimentation, and international exchange to broaden the repertoire of private-sector-led initiatives.

2. How to facilitate private sector dynamism?

Regional entry points

To get a better grasp on how to unleash private sector dynamism, let us examine a story of the Asian tiger within Mexico — the state of Aguascalientes. In the last decades, the state of Aguascalientes, around 250 miles north of Mexico City and 800 miles south from the Mexico-US border, has experienced an extraordinary performance in terms of economic growth and development. The state is one of the smallest in the country with 851,000 inhabitants in an area covering only 0.3% of the national territory. Traditionally and up to the late 1970s, Aguascalientes' economy had relied primarily on agriculture, complemented with some production of wine and garments (as the nearby States of Michoacan and to some extent Zacatecas still do now). This situation has changed radically since the early eighties, a period of fast industrialization in which Aguascalientes, has experienced rates of growth in both manufacturing and exports which far exceeded the national average. This growth has largely been fueled by considerable amounts of foreign direct investment (FDI), particularly from the Japanese automobile and U.S. electronics industries. How did this extraordinary growth come about?

- **Self evaluation of needs, weaknesses and strengths of the private sector**

In 1974, the incoming state governor decided to pursue a radically different development strategy during his tenure (1974-1980), and shift emphasis from agriculture to manufacturing. Given their limited experience in Industrial Promotion, their first action was to determine the main needs of industry. This was done by interviewing the owners of what were then the strong productive sectors: agriculture, winemaking, textile, garment, railroad repair, and some metal-working. Similarly, they contacted unions to understand the main concerns of labor. The results of their initial survey were not encouraging, for they realized that the state lacked important conditions to attract investment, particularly basic infrastructure.

- **Improving business environment for 'first mover' firms — an industrial park**

In 1973, Nacional Financiera (NAFIN, the federal industrial development bank) decided to support the development of medium cities in 23 states as part of the National decentralization program. This program included the creation of Industrial Parks which provided physical infrastructure, business development services, plus a very wide array of support mechanisms such as fiscal incentives and project evaluation assistance. The state government took advantage of the program by creating a trust for the Industrial Park of Aguascalientes, and donated 200 ha., 40 of which were urbanized with the support of NAFIN.

- **Firms invest, private industrial parks flourish, the image of the State changes**

The effort to strengthen the necessary infrastructure and services soon resulted in new investment for the state and a broadening of the local manufacturing base. Among the key firms established in the later part of the 1970s were three national metal-mechanics firms, and the first automotive components firms. Since the first industrial park was so successful in attracting industries, the trust funds have been used to build three more parks from the seed capital of the original industrial park. These years of the industrial development can be considered extremely successful in at least three ways: First, the creation of important parts of the necessary infrastructure prepared the basis for coming investment. Second, the creation of important networking institutions, such as chambers, where managers gather to exchange points of view facilitated problem-solving and dispute resolution. Third, a change in the image of the state: Aguascalientes was no longer perceived by the rest of the country as an agricultural state, but started building its reputation as an industrial state. With this critical mass of suppliers and buyers present, the state became attractive for firms searching for an adequate plant location.

- **Multinationals respond**

The first international project was Texas Instruments (TI) which started exploring options for a manufacturing plant in 1979. The government saw having the plant in the state as a priority, and worked to address legitimate concerns of TI. For instance, the waiver was obtained on the limitations on foreign ownership (which were typical during the Import Substitution Industrialization era), having to get direct approval from the president. Other key aspects attracting a first multinational to Aguascalientes were the stability of the local labor force, the high quality of workers to perform very detailed work (resulting from the embroidery tradition of the past), and the high participation rates of women in the labor force, which is particularly important for the electronics industry.

- **First 'shaker and mover' comes, others follow**

Once TI decided to settle in Aguascalientes, Xerox and Nissan soon followed. The three major multinational firms have all played an important role in the local economy by giving their employees access to a global knowledge network, plus contributing with the technology which is embedded in advanced manufacturing processes. In terms of R&D capabilities, all of them develop their product and process technology in their home countries, where they tend to centralize the R&D function (though Xerox has locally developed some product lines).

- **Today's challenge: linkages to local SME suppliers from the multinationals**

Even though both the government and firms have actively pursued vendor development programs, the amount of inputs provided by local firms is still quite small. This is the current challenge.

From vicious cycle to a virtuous spiral of institutional development

Before the transformation had begun, Aguascalientes experienced a vicious cycle of low expectations, low demand for institutional change and thus low investment and outcome. Concerted private-public effort resulted in a virtuous spiral of better investment environments, institutional reforms and enhanced private dynamism. Among the key institutional features of this transformation which were responsible for the unleashing of private dynamism almost everywhere are: focus on improvement of business environment, private-public partnerships to solve specific business problems , effective local economic development agencies, and the presence of an effective public sector entrepreneur (an extremely dynamic individual with the ability to listen to the private sector and gets things done under adverse circumstances).

Major lesson: focus on investor-friendly business environment

What causes business to invest in a given location? Attractive business environment – institutional factors affecting risks and returns of an investment project.

Instituto Tecnológico de Estudios Superiores de Monterrey (1997) has develop a model of business localization based on Porter's model that considers 8 groups of variables:

- Human resources
- Physical infrastructure and market access
- Quality of life
- Regulatory environment (costs of entry, exit and doing business)
- Technological development
- Suppliers and services
- Market conditions
- Investment promotion policies by state government

Business climate ranking by states

Table 1 shows an aggregated ranking of Mexican States indicating the investment climate and attractiveness of each of them. However subjective these rankings might be, they provide important information on the relative position of different states, and therefore, an approach to the degree of competitiveness of various geo-economic urban clusters, as well as an indication of the transaction costs levels they bear. Predictably, the stellar growth performer, Aguas Calientes, is at the top of the league while the South-Eastern states with dormant private dynamism are at the bottom of this ranking.

Table 1 Business Climate Ranking by States

State	Average classification	Rank	State	Average classification	Rank
Aguascalientes	7.06	1	Yucatán	4.82	17
Chihuahua	7.06	2	Oaxaca	4.82	18
Querétaro	6.67	3	Zacatecas	4.82	19
Baja California	6.62	4	Hidalgo	4.72	20
Colima	6.47	5	Durango	4.58	21
Guanajuato	6.43	6	Tabasco	4.54	22
Veracruz	6.39	7	Campeche	4.47	23
Jalisco	5.78	8	Nuevo León	4.46	24
Tlaxcala	5.73	9	México	4.12	25
Morelos	5.64	10	Sinaloa	4.12	26
Quintana Roo	5.44	11	Baja California Sur	3.92	27
Coahuila	5.31	12	Guerrero	3.83	28
Sonora	5.18	13	Nayarit	3.79	29
Tamaulipas	5.14	14	San Luis Potosí	3.65	30
Michoacán	4.94	15	Distrito Federal	3.49	31
Puebla	4.90	16	Chiapas	3.21	32

Source: Investment Attraction in Mexico. Index for business localization. Tecnológico de Monterrey, 1997

Entry points to improve investment environment

In fostering private sector development, the central challenge for the Mexican government and for the World Bank Group is to identify and implement interventions that can initiate and sustain the virtuous spiral of better state institutions and enhanced private dynamism. To unlock the spiral of institutional development, it may be useful to put special emphasis on tangible (concrete, visible) initiatives – not as a substitute for continuing policy and institutional reform, but as an "entry point" from which systemic constraints can be identified more specifically, and from which less tangible reforms would follow as corollaries. The government of Aguascalientes was unusually effective in identifying and implementing such entry points. Starting from private-public industrial parks to more broad-based initiatives related to reduction regulatory costs of exit and entry, and doing business, improvement of infrastructure and human capital. Noteworthy institutional features applicable to other localities are the following.

Learning from success: think locally, act globally

The stunning transformation of Aguascalientes has generated much interest from less developed states to replicate this success. If Aguascalientes whose private sector was as developed in the 1970's as exclusive of the neighboring and still lagging states of Michoacan or Zacatecas, why can't these other states repeat its success? Every state shall certainly strive to improve its investment environment. Yet there is no magical answer as to how to do it, where to start, how to proceed, and what is the correct sequence of events in the chain. In some states, there is virtually no constituency for reform of the investment environment and the primary task is consolidation of such constituency for reform. Because of regional diversity, entry points must vary from state to state. Industrial parks could have had an adequate entry point for Aguascalientes the 70's, yet this is hardly a good entry point in the modern Mexican economy. Private-public programs tailored to local circumstances but instructed by global realities is the order of the day.

3. Why regional programs?

Diversity of regional trajectories, constrains and opportunities

'Laundry list' of constraints on private entrepreneurship

Survey after survey in Mexico and Latin America consistently identify the following list of major constraints hampering private sector entrepreneurship:

- Regulatory costs of entry, exit, and doing business
- Legal framework related to security of contracts (e.g. enforcement of bankruptcy code)
- Cost of logistics (shipping, storage, and custom clearance costs)
- Access to technological and marketing support systems
- Human capital constraints
- Access to the real estate

Although the list of constraints is generic, the sequence of actions needed to alleviate them is not. Some constraints (related, for instance, to security of contracts) are a prerogative of the federal government. Regulatory costs are affected by both federal and state institutions. In Mexico, the deregulation agenda is increasingly shifting to the state and municipal levels, where the state (e.g. Jalisco discussed in this report) designs the continuing improvement ('mejora continua') of the regulatory environment.

Relative costs of constraints differ

A survey of 121 successful SMEs in Chihuahua, Jalisco and Michoacan performed for this study indicates that binding constraints differ from locality to locality. For instance, infrastructure remains the most salient constraint in Chihuahua but does not emerge as such in survey responses in Jalisco and Michoacan. In Michoacan, the major problem appears to be a public sector that is unresponsive to SME needs, and in the South of Mexico there is a vicious cycle of interlocking constraints. Each constraint from the above list is binding and reinforces the other. In such a business environment only heroic or insider entrepreneurs with a connection to the state government can effectively do business. Mirroring the micro-economic constraints, firm-level capabilities differ by the size of firm, its location, and particular industry hence SME promotion programs need to match this diversity. In reality this is not the case. As a result, the survey shows that entrepreneurs are not even aware of existence of many SME programs, and very few (such as CIMO of the Labor ministry) are perceived as both accessible and useful.

Bootstrapping: sequencing of actions to alleviate PSD constraints

The sequencing of actions which alleviate the major constraints differ from locality to locality. The generation of a demand and constituency for a better business environment is a first step. During the 1950s in Chihuahua, just such a constituency emerged (somewhat unexpectedly) as a by-product of local 'cowboy capitalists' who increased property prices by attracting maquiladoras from the United States. When they arrived, the maquiladoras created pressure on the local government to improve the infrastructure and deregulate – this is how a virtuous cycle of institutional reform and private development was launched. To unlock private sector dynamism, one engages in a pragmatic bootstrapping -- through the process of incremental bottom-up change in which a favorable balance of risks and returns encourages these firsts steps from many diverse entry points, and each move unlocks the spiral of institutional reform and private sector development.

Territorial outcomes: diversity of regional growth trajectories (Fig. 3)

With a combination of comparative advantage and local business environment, a number of distinctly different regional trajectories is emerging in Mexico.

- Maquila-related trajectory in the <u>border states</u> emerging on the basis of foreign investment or maquila operations (Baja California, Sonora, Chihuahua, Coahuila, and Tamaulipas), and/or local entreprenuership (Nuevo Leon).

- <u>Industrial districts trajectory</u> (Jalisco, Queretaro, Guanajuato, Aguascalientes), in which one can observe the emergence of FDI-driven industrial clusters and districts.

- A distinct pattern characterized by adverse consequences of industrial and environmental congestion in the metropolitan Mexico City area.

Less developed regions have trajectories such as the following:

- States where <u>tourism</u> is a determinant for growth – the Yucatan peninsula and Baja California Sur.

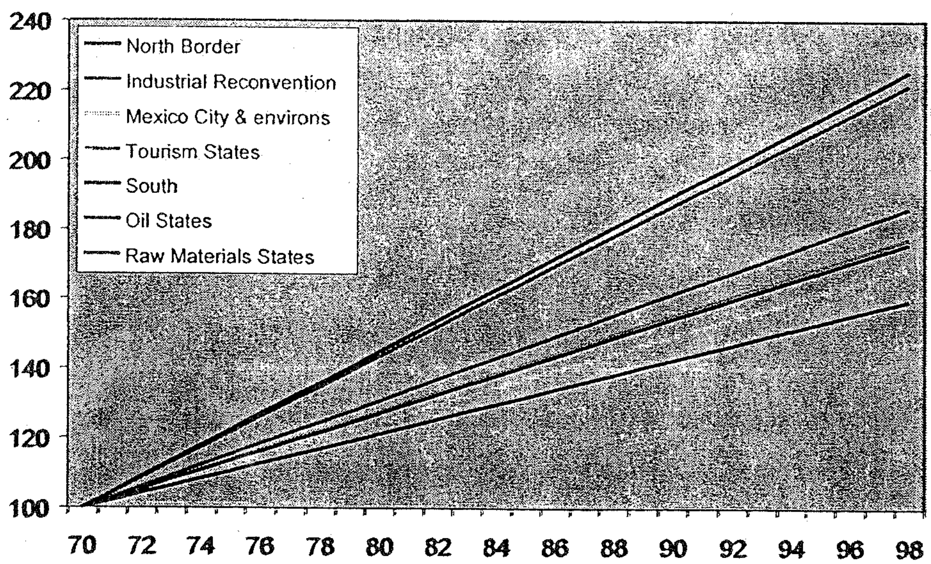
- Oil producing states (Campeche, Tabasco, and Veracruz) had not been able to develop local suppliers, relying instead on imports from the rest of the world and from other regions.

- In low income states (Oaxaca, Chiapas, and Guerrero) public investment and expenditures remain a key growth factor, along with a conspicuous lack of entrepreneurial development.

- Agriculture and forestry trajectory (Sinaloa, Durango, Zacatecas) driven by exploitation of natural resources with relatively low value-added.

Design of entry points should reflect diversity of regional growth trajectories.

Figure 3. Manufacturing Trajectories 1970-1998



Entry points for more advanced regions: promotion of inter-firm linkages

These entry points should be centered around regulatory changes, business development aimed at reducing initial risk and transaction costs of establishing collaborative relationships between large internationally competitive buying companies and their actual and potential suppliers. The outcome of such a relationship is to upgrade quality, technology, marketing, and design capabilities of suppliers, and better quality of inputs for the buyers. Promising programs of supplier development are abundant world-wide and are also emerging in Mexico.

Entry points for less-developed regions: creating conditions for 'first movers'

Less developed states are characterized by the vicious cycle of low expectations, low demand for institutional change and thus low investments and outcomes. To break this cycle from a private sector side, first movers – firms which enter new markets and do things differently are paramount. Traditional top-down industrial policies to attract investments have a decidedly mixed record. In contrast, successful 'light touch' bottom up interventions in countries as diverse as Brazil and EU latecomers suggests the following entry points (Box 1):

- Promotion of micro-business
- Facilitation of rural-urban linkages
- Promotion of entry of national and global players
- Facilitation of demand-driven business development services for SMEs
- Public procurements as a means to develop local SMEs
- Use of remittances from nationals working abroad for local infrastructure, micro, and SME development.

4. What works and why? Examples and principles of good SME programs

In Mexico, systematic efforts which evaluate promotion programs are still very limited. Yet even the limited evidence from Mexico and much more extensive documentation of world-wide experience shows that good industrial promotion programs are demand-driven, led by private sector beneficiaries and local in their formulation and implementation. Good programs provide incentive for private agents to learn and restructure and they abide to the following principles.

The 'Light touch' approach: complementing market and individual efforts

The economic and institutional perspectives suggest drawing a sharp distinction between initiatives that require only a light touch from the government (for example, matching grant schemes) and initiatives that require high-intensity government support (such as coordinating investment or picking winners). High-intensity initiatives should be approached cautiously, or not at all, unless the government has unusually strong

Box 1 From top-down to bottom-up horizontal industrial policies

The 1980s saw the demise—at least in Europe—of top-down industrial policies and their spatial correlate, regional economic development policies. By the early 1990s not a single national industrial policy initiative could be identified in Europe, and nationally determined regional policies were scarce.

Two factors explain the demise of centrally issued regional policies. First, they had a record of picking industrial lame ducks. Second, regional governments resented national policies aimed at their economies, complaining that local authorities were rarely consulted. The result has been a drop in spending on local development initiatives but greater regional spending on local development initiatives with greater regional input on how this funding is used. The increased involvement of regions in development initiatives did result in some hiding wars to attract firms, but it also led to strategic improvements. Ireland is a good example of these changes. The Irish program emerged from the national economic crisis of the mid 1900s, which was characterized by severe long-term unemployment and attendant social ills. The central government efforts to deal with the crisis were clearly not working, and budgetary pressure was forcing a reconsideration of social policies.

Out of this dilemma came the new Irish "social partnership." Which created decentralized centers for the employed managed by boards composed of representatives of local governments, training agencies, and the office of the Prime Minister. The centers serve as vehicles for re-targeting social assistance to focus on the most vulnerable groups, increasing the resources available for economic development. To complement the centers, the government fostered partnerships in the same areas (and in rural areas) with a mandate to enhance the competitiveness of local firms by making residents more employable. Finally, with the support of the European Union, the government created county enterprise boards that allocated project grants locally using criteria set at the national level.

Despite some weaknesses, the Irish partnerships are generally considered successful. The keys to their success are:

-- Their ability to draw directly on local resources, so that the experience of local businesspeople provides the foundation for enterprise creation and the unemployed themselves set up programs targeting the jobless

-- Their ability to adapt the objectives and resources of state agencies to local needs

-- Their capacity for improving the targeting of social welfare and thus the cost-effectiveness of providing it.

Source: World Development Report, 1999/2000

institutional capability. By contrast, light-touch initiatives are those that are inexpensive and accelerate existing demand-driven changes rather than those which are restrictive and command-oriented.

First movers are critical: since small firms learn most productively from each other, the success of a first mover provides powerful examples to follow and thus has a positive spill-over effect. Because of the spill-over effect, some public subsidy to first-movers is justifiable. How to deliver such a subsidy? The relevant knowledge (about export markets and on the upgrading of the firm) is highly specific and can be provided only by independent service providers. A firm-level management governance scheme proved to be a promising solution. This scheme includes creation of a public fund managed by a private management service provider to offset (usually on a 50/50 basis) certain fixed start-up costs of breaking into export markets. Funds are provided on a "first come, first served" basis – once eligibility criteria are met, every firm receives support, and the fund is temporary (3-4 years being a typical duration). The latter is important: once exporting ceased to be an innovative activity, thereby not leaving any learning spill-overs, there is no reason for the public fund to exist. The private management service provider administering the fund operates under a time-bound contract with performance benchmarks and acts as *global network information broker* (by providing relevant information to firms), markets the scheme to the firms, provides up-front, free support in preparing firm's programs and acts as an impartial administrator.

The 'Jazz orchestra' approach: orchestrating collective learning

Under this approach, the government (or central authority in general) *orchestrates decentralized learning by monitoring and assuring information-sharing between local experiments.* The central authority does not direct--it facilitates information sharing, encouraging improvisation and experimentation, as in a jazz orchestra. The jazz orchestra principle (information exchange through continuous networked interaction) is the underlying principle of the decentralized learning in many areas of SME performance.

Box 2 Government as a Facilitator: SMEs Adopt IS0-14000 Standards Through Innovative Supplier Development Program

In 1996, eleven large companies (domestic and multinational) in Guadalajara signed a two-year, voluntary agreement with Mexico's *Secretaria de Medio Ambiente, Recursos Naturales y Pesca* to mentor small suppliers in implementing environmental management systems (EMSs). Each company invited two to three small suppliers to participate in the pilot. The large companies and the World Bank provided the SMEs funding for EMS training and implementation support. A team of consultants – from two local universities and a foreign environmental management-consulting firm – delivered the services. The aim was to implement the ISO 14001 EMS model originally designed for large firms for the SMEs and evaluate the applicability of the model as well as the sustainability and replication of the pilot partnership. As of late 1998, the pilot was encouraging, with virtually all participating SMEs making major advances in the implementation of ISO 14001, the reduction of pollutants, and their ability to use general management systems. Moreover, the national government has used this experience to develop the substance and implementation methods for new environmental protection legislation.

The success seems to have depended on four principal factors. First, most SMEs indicated that the invitation from the mentor company, rather than simply from the government or university, was a vital source of motivation and cooperation. While all participating firms had some sense of "ownership" in the project, the presence of a large company "champion" provided important assurance that their dedication was not misplaced. Second, the use of the consultant network provided resources otherwise unavailable to SMEs and even many large firms. The network in effect provided a rapid response system to local and firm conditions through a diverse group of experts who drew on one another's wide range of skills and knowledge. Third, although they attended the pilot's sessions mainly as observers, representatives of local and national environmental authorities focused managers' attention on the project, and prompted many of them to learn about the benefits and drawbacks of different standards and enforcement actions. Fourth, beyond the training in technical issues, the use of benchmarks and an iterative, collaborative review progress both demonstrated new forms of cooperation to participants at all levels and improved the information basis on which they could build the next round of efforts.

The 'Champion' principle: importance of an industrial promotion organization with performance-oriented incentives and strong project execution capabilities

An example of such a local private-private champion is the economic development agency in Aguascalientes, discussed earlier. The performance of an industrial promotion agency, just like that of any other organization, is a matter of incentives and capabilities. The agency is expected to perform three basic functions. First, it facilitates *demand* for restructuring and learning by ensuring that managers and government officials share a mutual understanding for both the need for restructuring and the involvement of external consultants. Second, the agency assures the efficiency of the restructuring: it trains enterprise managers how to utilize external consultants. Foreign consultants are often of limited effectiveness to SMEs due to the differences in their language, social, and professional backgrounds. As a result, local consultants are needed to facilitate interactions. Trained locals tend to understand what makes an owner of a small firm tick. Finally, the third role of the Agency is a familiar role of market-driven consultancy – provision of managerial expertise.

5. How to scale up good programs?

A Decentralized system of industrial promotion

Local experimentation may succeed, centralized replication will fail.

Entry points which successfully unlocked private dynamism elsewhere cannot be mechanically replicated. Rather, local agents have to come together to design initiatives tailored to their local circumstances. In doing so, they must take into account relevant global and national experiences. The role of the federal government is to assure that successful experiences and programs are widely shared and scaled-up, while less successful onesare scaled down or discontinued.

Decentralized system of promotion envisions new roles of federal, State, and local authorities and civil society.

- ***Sub-national level*: piloting of innovative private sector driven initiatives (entry points) *at the state and regional level***
  - Grow out of discussion and debate within the civil society
  - Draw upon active participation of the private sector in financing, conception, and operation

- Built-in mechanism for evaluation and improvement in the light of the state's own experience, experience elsewhere in Mexico, and experience abroad

- *Federal level*: **continuous monitoring, evaluation, and technical assistance to state-level initiatives;**
  - Consolidation of existing programs
  - Making Federal programs driven by the demand of the states and private sector clients
  - Making Federal budgeting flexible, capable of adapting to demand and building upon experience, and mixing its funds with those of other sources as outlined below
  - Building in mechanisms for evaluation, for the identification of best practices at the state level and for collecting, evaluating, and disseminating international experiences
  - Built-in feedback from the state in a process of continuous improvements of their tools
  - Attracting top caliber talent to promote and facilitate the planning process, to administer the operating program and to guide experimentation and evaluation
- *Civil society*: **national process of vision- building and construction of shared change agenda**

The new decentralized incentive framework can be put in practice under the following three approaches.

Matching grants

Under this principle, the federal government agrees to match every peso, up to a certain limit, that state governments dedicate to economic-development projects decided in collaboration with private actors, on condition that those actors match the state contribution as well. The idea is simply that if the regional government and economic actors are willing to put their own money at risk to finance the projects they define together, then the Federal government can assume that their choices are well considered, and provide its backing as well. The advantage of this method is to impose some discipline on project selection with little or no increase in red tape. The economic actors, public and private (at the regional level) are given an incentive to sort through their priorities—seek potential problems—and the Federal government limits itself to ratifying their provisional decisions as they emerge.

Benchmarking of business environment

This approach also aims to discipline project selection while holding bureaucracy and the politics of clientelism generally in check. But it does this not by ratifying the actors' decisions, but rather by providing information on economic performance that cause them to reflect on their possibilities in new ways. The crucial information intervention could be the creation of a league table of regional economic performance, including, for example,

1) Business registration – cost (for all areas, including in time and formal and informal types of payments and contributions, including bribes), procedures required, delays

2) Business licensing – numbers and types required, cost, time, and payments required

3) Obtaining business premises – procedure, costs, constraints, delays

4) Business inspections – types (and agency responsible), costs, number, process followed

Contest for Federal funds

The main feature of this approach is contest among states and localities for Federal funds for infrastructure and private sector development. The main feature would be that the States will get Federal funds based on the quality of their proposals, so that excellent proposals could get more funding than other less compelling programs. The National Private-Public Council would grade the quality of the proposals. Proposals would share their strategies so even the losers would gain knowledge. Administration of such a contest may require capabilities of impartial project selection which may not yet be readily available in Mexico. This may not be an immediate option to consider but a proposition for the future.

6. How to arrive to a new system of industrial promotion?

Transition trajectory

A new cooperative framework between federal, state government and private sector can be introduced through the following initiatives:

Starting point: piloting of a new system in two-three states

One can propose a pilot program combining matching funds for SMEs and deregulation in 2-3 states of Mexico focused on investment environment. Such pilot initiative would provide incentives to provincial government, private sector and federal government to jointly design and implement innovative performance-based projects to improve state-level investment environment. For the purposes of this initiative, investment environment is defined as:

- regulatory environment, as documented by transaction costs of entry, exit and doing business
- human capital endowments of SMEs requiring investments into vocational and on-the-job training
- business development services to small and medium-size enterprises

As part of the required local solutions, there will be a need to examine the unfinished agenda of getting the state out of the way where its actions are unduly distortionary. A condition for getting access of states to federal matching grants would be to commit to undertake state or local-level deregulation (especially in areas where it has been difficult for the federal government to convince state or local-level counterparts). The limited multi-state pilot would allow testing of central facilitation and monitoring capabilities for local implementation, prior to rolling out the approach nationwide.

Starting point: Supplier development initiative

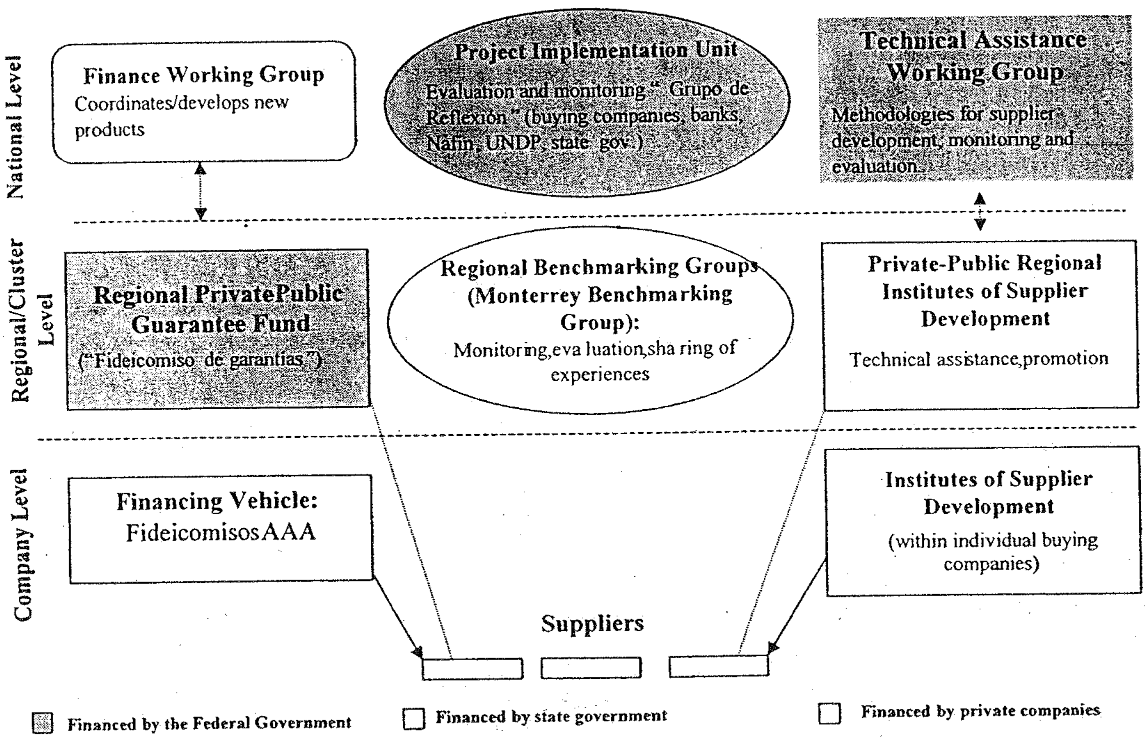
The objective of the demonstration supplier development initiative we propose here is enhancement of competitiveness of SMEs by fostering financial, marketing and technical linkages between large internationally competitive firms and small-scale suppliers of their inputs. This objective would be achieved through: (i) the improvement of access of suppliers – small and medium-sized firms -- to sources of finance and technical assistance ; (ii) promotion of better integration of SME support services provided on company, regional and national level; (iii) support of the Government promoted decentralization by strengthening State-level SME support institutions; (iv) design and implementation of monitoring and evaluation system to provide cost-benefit assessment for private, regional and national supplier development initiatives. The proposed system combines technical assistance and access to finance component at three levels – company level, regional/ cluster level and national level (See Fig.4).

On a company level ('micro-level initiatives'), interested large buying companies are starting to form Institutes of Supplier Development (technical assistance vehicle) and/or Fideocomiso AAA (a company-level trust fund to finance suppliers). The proposed initiative would not finance the private institutes but would provide assistance to help redesign fine-tune existing company-level supplier development efforts

On a cluster/regional level, large buying companies in collaboration with Secretaries of Economic Development of State government would form small private-sector managed cluster Institutes for Supplier development (in autoparts and furniture sector, for instance) to serve collective needs of a cluster. State governments and buying companies will provide financing of the Institutes.

On a national level, the issue is creation and dissemination of policy knowledge. The existing 'Grupo de Refleccion' of large buying companies to share their experience of supplier development (being convened jointly by UNDP and NAFIN) could be strengthened. Two technical working groups (finance and technical assistance) will be formed to coordinate development and testing of new products, and monitoring and evaluation of the outcome and impact. The Initiative would have an Internet-based monitoring and evaluation module facilitating documentation of private and social gains of supplier development efforts and sharing of experience. With accumulation of the documented experience of supplier development initiatives, the Private-Public Advisory council is to be formed consisting of top private and public leaders to provide strategic direction to supplier development efforts.

Figure 4 -- Mexico: Pilot Supplier Development Initiative



Transition at the sub-national level: matching roles to capability

Capabilities of State governments and the local private sector, and their ability to work together would determine the scale and scope of decentralized programs in practice. One can argue that in States where private sector capabilities for collective action are strong, while that of the State governments are relatively weak, the focus should be on demand-driven centrally financed programs rather than decentralization. Mexico is characterized by a wide diversity of capabilities of sub-national governments and the private sector. In some States (e.g. Nuevo Leon) private sector is stronger than the government, while in others (e.g. Oaxaca) they are less strong (see Table 2).

Table 2 Sub-National Governments and Local Private Sector: Matching Role to Capability

	Private sector capability – strong	Private sector capacity for collective initiative – weak
Sub-national government capability – strong	**Private-public decentralized programs** elaborated by local private-public partnerships and financed by sub-national governments (Northern and Central States)	**Government-led decentralized programs** Locally-tailored programs (promotion of local industries) (Oaxaca, Puebla)
Sub-national government capability – relatively weak	**Private-sector-led design of centrally-financed programs** Promotion of backward linkages, Technological and quality infrastructure (Nuevo Leon)	**Demand-driven central programs** First-come, first-serve matching grant schemes (similar to CIMO program) (certain States of the South-East)

Transition at the Federal level

The new role of Federal government is threefold. It is, first, to promote the process of discussion, debate, and discursive problem solving at the state and local levels. This process will result in private-public initiatives – entry points to unleash private sector dynamism. Second, it is to support that process with technical assistance and the mechanism of evaluation, continuous improvement, and program innovation. Most importantly, it must draw into this process a well-trained and committed group of men and women of the caliber of those which in the past supported state-led import substitution and, in the last ten years, devoted their talent to macro-economic management, privatization, and the negotiation of international treaties. Third, it is to facilitate the national process of deliberation and sharing of knowledge about promising state and sectoral initiatives involving all strata of civil society, private sector, and the government. Such a process, although it may not necessarily be an immediate priority, may be called Mexico 2025.

The first step in reorganizing federal programs would be to consolidate federal expenditures so that all programs are grouped together in a single budget. Ideally, that budget should be administered by one single agency as well, however, administrative consolidation may not be possible initially. The policy making process should nevertheless be organized around a consolidated budget. The second step in the reform of promotion policy would be to divide the consolidated budget into three broad functional categories: planning, operations, and administrative support for program evaluation, technical assistance, and promotion.

The planning function and budget would be almost completely decentralized to the states. Operational funds would be allocated to the states through a voucher-like system which would enable them to purchase program components from Federal agencies. The Federal Government would retain responsibilities for Program Evaluation, technical assistance and promotion, and set up new mechanisms to accomplish these tasks.

Transition at the societal level: shared vision of the change agenda

One can think of a highly participatory process Mexico 2025 (similar to El Salvador 2021, Malaysia 2020, Rio Shared Vision) to facilitate institutional experimentation through joint private-public-civil society dialogue. The vision-building processes could start at the state level and could learn from the highly successful experiences such as Monterrey 400 and Chihuahua Sigil XXI. The basic idea is to unleash creativity of the private sector and civil society by a shared vision of the future and implementing this vision through joint projects.

Institutional design of the new decentralized system

Basic institutional architecture of transition to the system comprises the following three elements:

(i) A distinct regulator and financier as third level (tercer piso): National Advisory Council

Ideally, a Private-Public Council with substantial private sector participation would be in charge of defining the rules of the game (Statement of Policies and Operating Procedures), and entrusted with ex-post monitoring control to ensure the well-functioning of all operating procedures.

ii) An independent management unit as second level (segundo piso): To ensure that there is no conflict of interest regarding how to disperse funds. The unit responsible for administering resources and intermediating between supply and demand ideally should be credibly independent and follow transparent Operating Procedures for resource allocation. The resource allocation procedures should be designed to minimize any tendency for corruption and clientelism, and could range from (a) first-come first-served , to attempt to minimize discretion in the allocation of subsidies to (b) a more elaborate contest where entrants (enterprises and associated public and private service providers) would have to explain their accomplishments to date and how new activities could strengthen themselves, existing institutions and the economy.

(iii) A diverse array of national and international service suppliers as first level : These are generally private sector consultants, but could also include public sector service providers as long as they charge for their services and compete on an equal basis with other private providers. As a guarantee of the relevance and need of any service to be provided to the enterprises themselves, it would be pre-requisite that the enterprises contribute a strong element of their own private financing, typically at least 50 % towards the costs of fees and associated expenses of external support services.

From starting points to a possible national decentralized PSD program

With the accumulation of experience with state-level pilot program, gradually and over time, the following national program can be introduced to test contests between sub-national entities for federal matching funds. The first step is to recognize that in Mexico there is de-facto intense competition between sub-national authorities in attracting investments. In effect, sub-national authorities compete with each other to provide a better investment environment. The second step is to recognize that this existing competition has important limiting features in terms of its protagonists and instruments:

- It is limited to large shakers and movers: multinationals and domestic corporate groups. SMEs are often so far off in terms of their capabilities that they are not even perceived as strong agents capable of making a difference at the local level.
- It is limited to the strongest sub-national entities. The investment environment of less developed states is so weak that they often have no motivation to woo investors by improving the investment environment. To substitute for the weak investment environment, special favors like tax holidays are sought.

The competition for investors often has a strong component of rent seeking. Less developed regions perceive that they are entitled to subsidies, tax holidays and other forms of preferential treatment to level the playing field between weak and strong sub-national entities. The problem is not subsidies per se but the fact they are allocated in a way that undermines incentives to engage in improvement of incentive environment.

From implicit contests to transparent competition between sub-national 'competitiveness projects'.

Can one remedy the flaws mentioned above? Can one broaden efforts in improving the investment environment by motivating the less-developed states? Can one deepen the competition for investors by explicitly including SME- related programs? Can one make allocation of subsidies more transparent?

Imagine that each state with a motivation to improve investment environment presents a plan, a state-level competitiveness project outlining what kind program it would like to put together which addresses, for instance, the following issues:

- Deregulation and reduction of administrative costs for entry, doing business, and exit
- Business development services for firms and facilitation of linkages between large firms and SMEs
- Enterprise training and university-industry linkages
- Reduction of logistics costs in supply chains

Initially one can start from one issue from this list. The idea is to have a two-prong competition to make both the strong as well as the less-developed states compete in different leagues, with federal technical assistance available for less developed states to help them put together meaningful projects. As a demonstration of commitment, each proposal would secure some financing from sub-national governments and the private sector. For instance, if the state governments propose a design center for shoe-making SMEs, it has to put their own funds and secure co-financing from private sector beneficiaries. The contest thus is a familiar bid for federal subsidies, except that the sub-national competitiveness projects are open-ended. The point of the contest is motivation for private-public creativity. The contest is an incentive device for private and public actors to come together and develop innovative solutions to improve the investment climate on a sub-national level: it is about waking up social energy and creativity.

<u>What are the criteria to determine winners and who are the judges?</u>. Every contest requires rules, transparent criteria to determine winners, and judges. One can think about two types of criteria:

- Credibility of the past efforts to improve the sub-national investment environment and competitiveness
- Creativity of and commitment to state-level competitiveness proposal to improve the investment environment

A set of sub-national indicators has been developed to monitor the sub-national business environment and state-level competitiveness. For instance, Monterrey Institute of Technology in Mexico monitors major state-level indicators of competitiveness (discussed in Chapter 2) on an annual basis. States putting more effort could see their progress by reviewing the numbers and charts, and the benchmarking exercise did gain credibility among the government and private sector investors.

The second criteria, the quality of the sub-national competitiveness proposal is, by definition, subjective. The credibility of the contest will be vested in a Private-Public Advisory Council consisting of top private sector leaders and public sector managers with vision, standing, and reputation for honesty. An impeccable reputation of the Advisory Council which will allocate federal subsidies to sub-national projects is one safeguard that discretion in allocation of public money will not lead to self-dealing. The second safeguard is the matching grant principle. State government and private sector beneficiaries will have to demonstrate commitment by contributing their own resources, both in cash and in kind. The competition is for the size of the matching funds from the Federal level. The third safeguard is the stipulation that there will be no losers. Every state that has developed a high quality proposal and demonstrated commitments of private stakeholders will receive some federal contribution.

The contest achieves its objectives by providing motivation to a sufficient number of states who participated and not so much by the amount of federal funds disbursed. To sum-up, the rationale for the contest, is three-fold:

- As an incentive device for sub-national government and private sector to engage in meaningful joint action and reform.

- As a coordination device to stimulate joint activities of the Federal and local governments and private sector beneficiaries under the umbrella of private-public competitiveness projects.
- As a mechanism to share policy knowledge. The idea is that innovative promising solutions emerging in one locality will quickly be adopted in the other.

The implementation of this mechanism could take the form of a Trust Fund (fideicomiso) financed by multilateral agencies and the Federal Government. Access to the funds should include a bidding process designed in such a way that cities belonging to the same clusters had an incentive to cooperate and present their proposals jointly. State governments could participate along with municipalities. In the case of clusters located in more than one State, participation of State administrations could be particularly appropriate. Each cluster should define the kind of investment and/or technical assistance, provided that the intervention is at the cluster level. Proposals including public-private partnerships should be encouraged.

7. What is the role of International Financial Institutions?

Which is a comparative advantage of international financial institutions?

Institutional development takes time. Relevant World Bank projects (like supplier development initiatives) are design- and implementation- intensive. Does the IBRD have a comparative advantage in relation to IFC and grant-based activities of philanthropic foundations? If so, which is this comparative advantage? The report argues that grant-based support to small pilot projects, the World Bank interventions, and the IFC involvement are all have a role to play but on different stages of organizational evolution

Stages of organizational evolution and comparative advantages of donors

Private-public organizations – local economic development agency in Aguas Calientes, supplier development agencies in Jalisco and Chihuahua and other organizations discussed in the Report --appear to evolve in through the following stages:

- Organization as a group of champions (*embryonic stage*) involved in experimentation and piloting of appropriate organizational model. This is the stage which warrants grant support of philanthropic foundations and UNDP. Supplier development intitiaves of UNDP is an example of the best practice.

- Private-public organization demonstrates results and gains credibility, yet it may still need some public support to generate demand and enhance supply of its services (*infant stage* of organizational development). At this stage the IBRD can provide the most value added through its knowledge-sharing role.
- The private-public organization has generated sufficient client base to support itself commercially. This is the stage of the IFC involvement.

In this approach the World Bank helps *to graduate* bottom-up initiatives supported by grants (Inter-American Foundation, UNDP, Multi-lateral Investment Fund of the IDB) into the commercial market place supported by the IFC. An example of such approach is Zacatecas supplier development imitative to be supported by joint IFC-World Bank SME Department, which is currently under preparation. It builds on a diversity of grant-based efforts of UNDP, and has an explicit intention to develop the initiative into a commercially sustainable IFC project.

Bottom-up approach to donor coordination

In this example, coordination between grant-making donors (UNDP), IBRD and the IFC is occurring in a bottom-up fashion and through active involvement of state government. The state governments assures grant support to creative group of private and public champions, then brings the Ibis, and as relevant organizations matures and develops a knowledge base, it becomes ready for IFC support on a purely commercial basis.

Three roles of the World Bank

Following the three-prong approach to transition to the decentralized incentive framework (state-level initiatives; Federal facilitation and monitoring of regional initiatives; shared change agenda), the World Bank has three roles to play:

- Support to state-level pilot initiatives: regional PSD LILs
- Support to scale-up regional experiment and to federal system of facilitation and monitoring: possible Competitiveness Adaptable Program Lending
- Support to the national framework of shared vision-building: non-lending services – the World Bank as a knowledge broker.

Table 3 provides a summary of new decentralized PSD framework and introduces the possible role of the World Bank and other international organizations to support it. Table 4 summarizes the summary of the current and possible World Bank Group activities in facilitating institutional development for PSD.

Table 3: Project cycle of programs and the World Bank projects

	Role of local private-public partnerships	Role of Federal government	Proposed World Bank product	Relation to the new Bank's project cycle 'Listening' – 'Piloting' – 'Learning' – 'Monitoring'
Preparatory phase I **Design** *of decentralized demand-driven system*	Participation in the design of the new system	Leading role: design of a consistent system	**Knowledge sharing: best-practice seminar** 'Regional Development and Decentralization'	*Listening* – helping the stakeholders (local private-public partnerships, federal government) articulate demand and institutional configurations of new projects
Preparatory phase II **Matching roles to capability**: *Assessment of private-public partnerships in selected States*	'Where we are and what to do next?' -- self-assessment of sub-national comparative advantage and capability for collective action	Elaboration of methodology for the self-assessment of private-public partnerships	**Assessment of private-public partnerships**: Evaluation of the capability of local stakeholders to design and implement decentralized programs	*Listening* – assessing implementation capabilities
Preparation of **pilot projects** (LILs) in selected States	Leading role Preparation of the projects as the outcome of sub-national self-assessment	Assistance with the design of State-level projects	**Private Sector Development LILs** in selected States	*Piloting* – testing new institutional arrangements
Implementation and monitoring of pilot projects in selected States	Provision of information	Leading role Design of the methodology. Learning from mistakes and successes	**Monitoring and benchmarking methodology** for local private-public initiatives and LILs	*Monitoring* – learning from successes and failures
Mainstreaming of the decentralized approach to all States	Readiness to share local successes and failures	Knowledge sharing: dissemination and best-practice fora	**Adaptable lending program** for private sector development	*Mainstreaming* – scaling-up of the pilot projects to national level

Table 4: World Bank Support: Three-prong Approach

	Activities completed, dropped or under preparation	Proposed activities
1. Support to State-level initiatives (entry points)	Regional PSD Yucatan LIL (with Nafin) Border Infrastructure LIL (with SEMARNAP), dropped) Mexico City micro-business pilot Centro Mexicano de agro negocios IDF (with Sagar) IFC-IBRD Zacatecas Supplier Development Initiative	Supplier Development LIL (Jalisco, Chihuahua, Aguas Calientes)
2. Federal system of facilitation and evaluation	Competitiveness Enhancement project with SECOFI (dropped) Remittances for SMME and infrastructure development (NAFIN) Decentralization of Industrial Promotion ESW (SECOFI, NAFIN)	Competitiveness enhancement APL Seminar on Decentralization of Industrial Promotion
3. Knowledge broker for the national shared vision and change agenda Mexico 2025	Mexico 2020 series of seminars with ITESM (Monterrey, 1998, Mexico City, 1998, Mexico City, 1999, 2000, Campeche 2000);	Mexico 2025 series of regional seminars with ITESM as part of preparation Competitiveness APL and financed by PHRD grant

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May 2, 2001

Volume II
Main Report

Finance, Private Sector and Infrastructure Sector Management Unit
Country Management Unit 1
Latin America and the Caribbean Region

CURRENCY EQUIVALENTS

Currency Unit = New Mexican Peso (N$)
US$1.0 = N9.13 (August 28, 2001)

FISCAL YEAR

January 1 to December 31

WEIGHTS AND MEASURES

Metric System

MAIN ABBREVIATIONS AND ACRONYMS

ADAE	Acuerdo para la Desregulación de la Actividad Empresarial
BANCOMEXT	Banco Nacional de Comercio Exterior
CADELEC	Cadena Productiva de la Electronica
CANACINTRA	Camara Nacional de la Industria de Transformación
CEDE	Centro para el Desarrollo Empresarial
CEDECE	Comisión Estatal de Desarrollo Economico y Comercio Exterior
CETRO-CRECE	Regional Centres for Entrepreneural Competitiveness
CICEJ	Shoe Chamber in Jalisco
CND	Consejo Nacional de Desregulación
COMPEX	Export Promotion Mixed Comission
COMPITE	Committee for Productivity and Technological Innovation
CONACYT	Consejo Nacional de Ciencia y Tecnología
CONCAMIN	National Confederation of Industry Assoc.
FDI	Foreign direct Investment
FUNTEC	Fundación para la Innovación Tecnológica de las MyPes
HP	Hewlett Packard
IDEFT	Instituto de Formación para el trabajo
INEGI	Instituto Nacional de Estadistica, Geografía e Informática
ISI	Import Substitution Industrialization
ITESM	Monterrey Institute of Technology
ITESO	Instituto Tecnológico de Estudios Superiores de Occidente
MIPO	Mexican International Procurement Operation
NAFIN	Nacional Financiera
NAFTA	North American Free Trade Agreement ¿???????
NGO	Non-government Organization
PAFIs	Financial Action and Investment Plan
PIU	Project Implementation Unit
PSD	Private Sector Development
SECOFI	Secretaría de Economía
SEMARNAP	Instituto Nacional de Ecología
SEPROE	Secretaria de Promocion Economica
SEPROE	Secretaría de Promoción Económica
SME	Small and Medium Enterprises
TELMEX	Telefonos de Mexico
TI	Texas Instruments
UDE	Unidad de Desregulación Económica
UNDP	United Nations Development Program
USI	Universal Scientific Industrial Company

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Think Globally, Act Locally:
Decentralized Incentive Framework for Mexico's Private Sector Development

Part II – Main Report

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Introduction: Challenge of Institutional Development

Problem and emerging solutions that show promise

The challenge of institutional development in Mexico, as it emerges in the Chapters of this report, can be cast as a parable of two small and family-owned garment firms, one in Chihuahua and the other in Michoacan. They share the same history and are almost identical in their endowments of human and fixed capital. Yet one is prospering and exporting, while the other is struggling to survive. The successful firm was able to plug-in into world-wide garment networks. Through this collaboration it takes advantage of design and marketing capabilities of leading firms in Mexico and the US. More generally, it learns about product differentiation and the importance of just-in-time delivery. Given the rapidly changing tastes of consumers and designs of clothes, and the demanding production and logistics disciplines needed to keep pace with these changes, the successful firm is becoming part of the new, knowledge-processing economy. Its small size and modest resources are not obstacles to success precisely because manufacturing and marketing skills reside in networks, not individual firms.

In contrast, the struggling firm is at risk, precisely because, like so many other Mexican firms, it is trying to survive on its own, largely cut off from leading foreign corporations with direct investments in Mexico and from other domestic companies. All the knowledge-induced changes that create opportunities for the first firm are threats its neighbor. For the same disruptions of routine and habit that allow the first firm to convert inexperience into open-mindedness and the ability to take a fresh approach, create daunting risks for the second. Worse yet, the first firm is learning how to learn the second only how much it does not know. The first firm embarks on *a virtuous circle of learning* (success breeds success -- inclusion in knowledge networks brings new expertise and makes subsequent learning more productive), while the second one falls into a *vicious circle of poverty* (failure breeds failure: exclusion from knowledge networks diminishes further chances to catch-up). In a global economy increasingly characterized by rapid, non-linear changes from unexpected sources, the success of individuals, firms, regions and national economies is based on their capability to learn to learn by entering virtuous circles while of course avoiding, or rapidly extrication themselves form vicious ones. Put bluntly, learning to learn is critical when change is.

Government has neither the capabilities nor the information to solve problems of private agents

All of a sudden, the story, being set in Latin America, takes a magically realistic turn: A high and benevolent government official comes upon the neighboring firms. He sees at glance what government ought to do: help the struggling firm escape its vicious circles and participate in learning networks. After all, given the similarities in the firms, and the demonstrated success of one, the failures of the other look more like an accident than like destiny. Surely the role of government, in parables and reality, is to protect citizens and their crucial projects from avoidable accidents?

But getting from the general idea of what to do to the specifics of how to do it proves a mighty chore, the government's good intentions notwithstanding. A young official, clear minded and innocent of all the past missteps of economic development policy (the realism is still magical, after all), is charged with figuring out the how. Focusing just on the two neighboring firms she quickly notices subtle but relevant differences: The successful firm had access to capital at a crucial moment through the owner's rich uncle; the owner of the failing firm was not favored by rich relatives. But regional banks and government lending programs have so much trouble assessing the prospects of turning the firm around, that they hesitate to make a loan. With regard to skills the story is similar. When it comes to hands-on experience with garment making, both owners are similar. But the successful one has five more years of formal schooling (the rich uncle again), and so can read manuals on factory layout, plant organization, the correct way to sew a new kind of fabric or accounting with a facility that the other owner can not. This difference is exacerbated by the fact that the good reader doesn't really need to read all that much because she gets further instruction in all these areas from customers and suppliers. But in order to overcome her isolation, the functional illiterate may have to rely on the very books closed to her. There are even differences with regard to access to intermediate goods like thread and fabric. The successful firm now gets these from its customers or their overseas suppliers. The failing firm has to rely on the products supplied by domestic firms, almost all members of a cartel with long habits of manipulating prices and quality while limiting variety. Caught in yet another vicious circle, the failing firm has a hard time showing prospective customers that it could make good use of higher quality fabrics and threads if given the chance to use them.

The official is bewildered. This list is the result of cursory inspection. Is it complete enough? How would one know? When the cost of additional information exceeds the benefits it confers? How would she know *that*? Can she just ask individual firms what they need? Probably not, because many of the most isolated firms, cut off from any experience of the new ways of doing things well, will be hard pressed to say just what it is that they don't know how to do. Is there a way that firms can learn enough to say what their problems are without already having solved them?

Suppose, because our parable is about the real world, that the official, pressed for time, decides that the cursory list is complete enough for starters. But what about the sequence of remedial measures? Plainly it is impossible to change everything at once. So change must be stepwise. But some steps may be preconditions for the success of others. So the stepwise changes can't be ordered haphazardly. It makes sense to offer literacy training before providing finance, so current reading informs the use of the fresh money. But wouldn't the credit, and the restructuring it enables, create a sense of urgency and opportunity that will motivate attention to remedial reading classes? What about doing both simultaneously? And what about reform of the domestic thread cartel, if the domestic producers really are engaged in unlawful collusion (and if the government can do something about such things)? As soon as these questions are formulated, they tangle into a Gordian knot which we will attempt to disentangle in this report.

The Gordian knot illustrate a challenge of institution building (sometimes called second-generation reform). Institutional infrastructure of private sector development: design bureaus to provide our garment firm with modern designs, testing and measurement facilities to test the quality of the output, private service providers in marketing, management and technical capabilities are quite weak. If they exist, they are mostly relegated to large metropolitan areas. Note that our successful garment-maker in Chihuahua managed to forego the weakness of local institutional infrastructure by connecting to global network of design, marketing and technical capabilities. Little was available locally. Our failing firm in Michoacan was less lucky.

The central question of this report is about facilitation of public good -- efficient institutions of private service delivery benefiting firms of all sizes, but particularly SMEs. We will show that such institutions are better to be created at the state and regional level and then scaled to the national level. This second-generation institutional agenda is in the center of new decentralized system of private sector development to be discussed in this report.

The report conveys the following five main messages:

1. Growing diversity of regional growth performance holds both promise and should be a source of alarm. Chapter 1 documents seven distinct regional growth trajectories and formulates Mexico growth paradox: a highly uneven supply response to globalization.
2. Although institutional infrastructure of private sector development remains quite weak, there are promising attempt to strengthen this infrastructure through private-sector-led initiatives at state level. Chapter 2 summarizes case studies of relevant regional initiatives in Jalisco, Chihuahua and Michoacan and -- drawing on these case studies -- provides conceptual framework to think about PSD infrastructure.
3. Facilitation of PSD -- public sector involvement to facilitate the institutional infrastructure -- should supplement and accelerate not supplant private sector initiatives. Chapter 3 summarizes relevant best practice world-wide and in Mexico, and provides operational suggestions on formulation of private-public initiatives -- entry points for regional institutional development.
4. A decentralized system of facilitation of PSD to address Mexican regional diversity should be radically different from the existing one. A new system should provide incentives to learn and improve for everyone, including localities and firms with very weak capabilities. Chapter 4 outlines such a system as capability-compatible incentive framework to learn and restructure.
5. Although the required system is radically different, the transition can be accomplished by piecemeal and incremental steps on Federal and sub-national levels. Chapter 5, central in the report, suggests a transition trajectory for key stakeholders -- private sector, federal and sub-national governments and the civil society.

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Chapter 1: The Paradox of Mexico's Economic Growth

1.1 Highly uneven supply response to economic liberalization

Since the 1980's, Mexico embarked on a new economic development policy, abandoning its commitment to import substitution industrialization (ISI). Since then, economic policy has increasingly moved toward reliance on market mechanism and macroeconomic policies to direct the evolution of the microeconomic structure and the development of the export-oriented manufacturing sector. As part of this policy, Mexico liberalized imports, controlled inflation, reduced public expenditures and taxes, and generated incentives to attract foreign investment. These changes reduced the dynamics of the domestic market. Export dynamics was unable to compensate for this decline causing growth to slow. Table 1.1. shows that growth did not recover until the late 1990's.

Table 1.1. GDP, Domestic Demand, and External Demand

	Index numbers (1980=100)			Annual Growth Rates			Share of Total Demand	
	GDP	Domestic Demand	External Demand	GDP	Domestic Demand	External Demand	Domestic Demand	External Demand
1980	100.0	100.0	100.0	9.2	16.3	-8.8	93.1	6.9
1981	108.5	109.6	111.4	8.5	9.6	11.4	93.0	7.0
1982	107.9	100.9	136.5	-0.6	-8.0	22.6	90.8	9.2
1983	104.2	92.4	155.9	-3.5	-8.4	14.2	88.8	11.2
1984	107.8	96.3	164.9	3.4	4.2	5.7	88.7	11.3
1985	110.1	100.0	157.5	2.2	3.8	-4.5	89.5	10.5
1986	106.7	95.5	164.6	-3.1	-4.4	4.5	88.6	11.4
1987	108.6	96.5	180.2	1.7	1.0	9.5	87.8	12.2
1988	109.9	100.3	190.6	1.3	3.9	5.8	87.6	12.4
1989	114.6	105.9	201.4	4.2	5.6	5.7	87.6	12.4
1990	120.4	113.3	212.1	5.1	7.0	5.3	87.8	12.2
1991	125.5	119.8	222.8	4.2	5.7	5.1	87.8	12.2
1992	130.0	127.1	233.9	3.6	6.0	5.0	87.9	12.1
1993	132.5	128.4	252.9	2.0	1.1	8.1	87.2	12.8
1994	138.4	135.6	297.9	4.4	5.6	17.8	85.9	14.1
1995	129.9	116.6	387.8	-6.2	-14.0	30.2	80.1	19.9
1996	136.6	123.2	458.4	5.2	5.6	18.2	78.3	21.7
1997	146.1	134.2	518.0	7.0	9.0	13.0	77.7	22.3
1998	152.8	139.9	559.0	4.6	6.5	9.9	77.1	22.9
1999	158.4	146.9	648.5	3.7	3.4	13.9	75.4	24.6
Averages								
1960-1981	6.7	6.9	7.7	6.7	6.9	7.7	93.3	6.7
1982-1994	2.2	1.9	10.5	1.9	1.8	8.1	88.2	11.8
1995-1999	5.1	6.1	13.7	2.8	2.1	17.0	77.7	22.3

Source: INEGI. Sistema de Cuentas Nacionales de México

Dual economy

There are two highly disparate economies in Mexico, with traditional sectors such as agriculture stagnating, and others, such as services—which now account for 47.3 percent of GDP—growing strongly. Mexican private sector has a **bifurcated structure** in which internationally competitive firms, located mostly in the center-north of Mexico, coexist with largely domestically oriented and often non-competitive SMEs, with limited linkages between these two sectors.

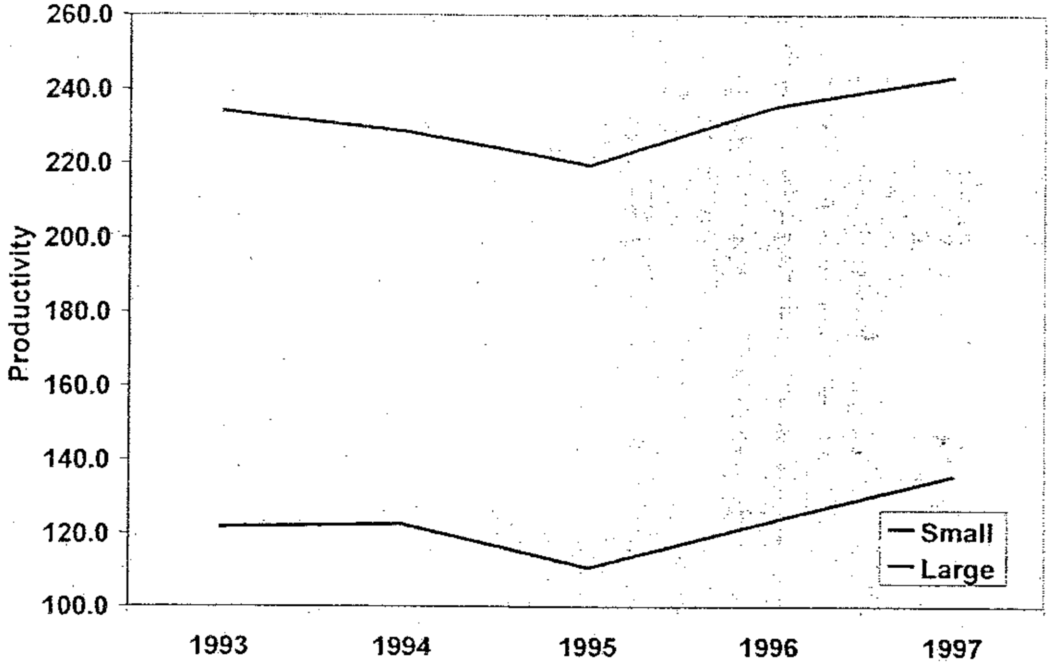
Fig. 1 Dynamics of labor productivity of large firms vs. SMEs, INEGI data

Concentration of export-led growth in few firms

Manufacturing is the most important productive sector and the main source of exports (89.4 percent of the total in 1999). Over half of the total, 52.2 percent was produced in *maquiladoras*. Although the country has experienced a boom in trade (double of what it was five years ago), the export base has remained rather narrow and concentrated in a few larger firms. According to the president of the National Chamber of the Industry of Transformation (Canacintra), of the 2 million firms in Mexico, only 4,000 are direct or indirect exporters, and only 300 industries have international commercialization capacity.

Furthermore, the Mexican export sector remains very dependent on imports of intermediate and capital goods. Mexican firms supply only 4 percent of inputs to the export sector. This dependence has meant that export growth has increased the import bill. For 1999, Mexico reported US$895 million trade deficit in December, the highest in 13 months (INEGI data). Mexican policies need to improve competitive conditions of both export-oriented (other than maquila) and local-oriented economies.

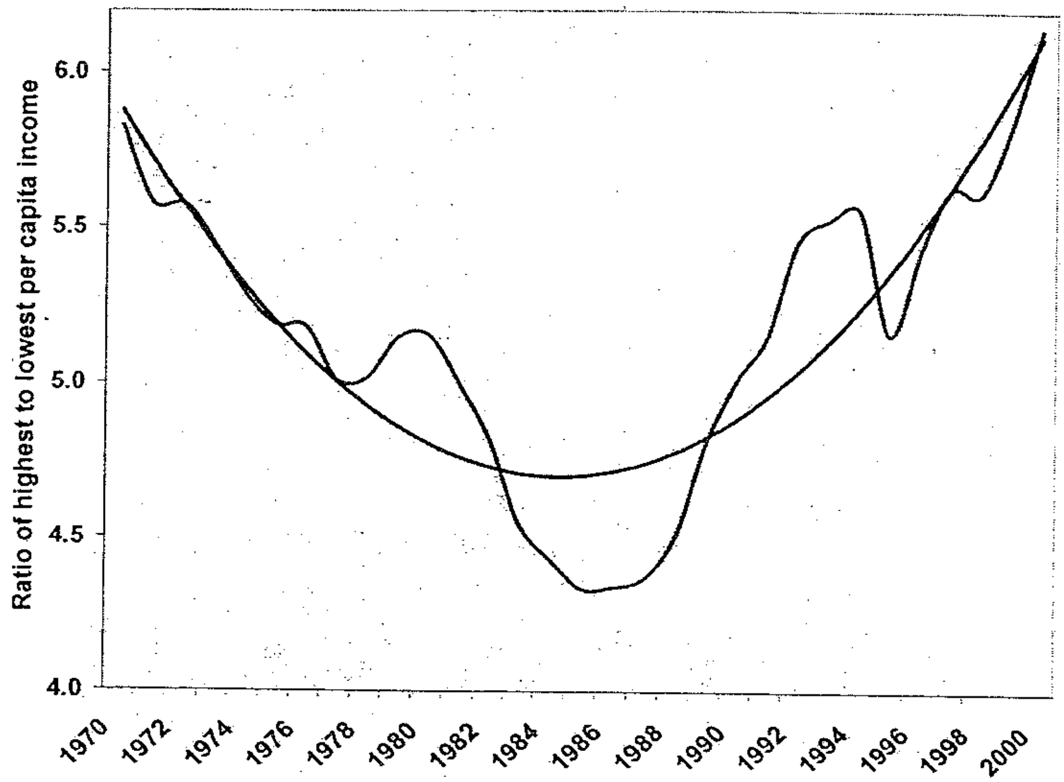
Fig. 1.1 Dynamics of labor productivity of large firms vs. SMEs



Increasing regional growth inequalities.

After World War II, the policy focus on import substitution was based on vertical integration. One location was enough to maintain the main market of the economy, creating what can be called a mega-city industry complex around Mexico City and causing the growth of metropolitan Guadalajara and Monterrey as well. With economic liberalization of the late 1980's, the multiple location system brought in a new dynamic and opening the space to a new agglomeration stage. Agglomeration economies and economies of scale increased in the new locations, affecting GDP inequalities among regions, pushing the ratio upwards once again, and reaching 5.5 times in 1996. Fig. 1.2 demonstrates that the gap between the wealthiest Mexican states (mostly located at the center-North of the country) and poor states with dormant private dynamism (mostly in the South-East) continues to grow.

Figure 1.2: Ratio between the highest and the smallest values of GDP per capita between federal states



Slow formal employment growth coupled with the depression of real wages affected behavior of the domestic market causing those businesses related to the domestic market to severely suffer. Most of them were SMEs that were unable to cope with foreign competition. In contrast, outward-oriented sectors profited from the boom in exports having an annual average growth rate of 17% in the same period.[3] This heterogeneous behavior can be shown explicitly from disaggregated data of National Accounts. In Table 1.2, sector development is classified in highly dynamic sectors (those with an increase in output between 5-15%); slowly growing sectors (those with growth below 5%); stagnant sectors (no growth); and declining sectors (negative growth.)

[1] Minimum wages are adjusted annually on the basis of expected inflation. Up to now the only year that expected inflation was below expectations was 1999, so there has been a deterioration of real wages. Contractual wages had to follow minimum wage settings, and in some cases there are productivity compensation.

[2] This average was estimated of the 205 classes of the Monthly Survey of Industry – Encuesta Industrial Mensual (EIM).

[3] Export expansion was due to manufacturing exports whose growth was even higher.

Table 1.2 Heterogeneity of Manufacturing Industry, 1994 to 1997

Highly Dynamic Sectors		**Slowly Growing Sectors**	
Electronic and other electric equipment	14.5	Leather and leather products	2.5
Primary metal industries	11.3	Food and kindred products	2.3
Industrial machinery	11.0	Lumber, wood products, and Furniture	2.0
Motor vehicles and equipment	10.3		
Apparel and other textiles	7.5		
Textile mill products	7.3		
Fabricated metal products	6.7		
Rubber and misc. plastics	5.6		
Paper and allied products	5.3		
Chemicals and allied products	5.0		
Misc. Manufacturing industries	4.9		
Stagnant Sectors		**Declining Sectors**	
Stone, clay, and glass Products	0.8	Petroleum and coal products	-2.2
Tobacco products	0.4	Other transportation equipment, Instruments, and related	-5.4
Printing and publishing	0.3		

Impacts on the economy were heterogeneous in terms of employment, productivity, and backward linkages. Dynamic sectors with a high export coefficient were responsible for the creation of new jobs. Paradoxically, they were the ones with a higher import coefficient, affecting backward linkages—and indirectly—employment in the rest of the economy. Stagnant and declining sectors were the ones having a lower impact on employment, but had larger productivity and low import coefficients with larger backward linkages.

As the *manufacturing imports coefficient increased from 0.81 in 1994 to 0.94 in 1999,* the overall effects on employment and productivity were positive, but negative in terms of backward linkages. In fact, production substitution for imports (reversed substitution), pushed many industries into crisis, mainly SMEs. Firms in this segment experienced two effects. First, they faced a decline in demand from the domestic market, and second, they faced increased competition from imports. Second, fragile network relations which existed before the opening of trade deteriorated rapidly as small businesses were not able to upgrade to world standards, causing them to be substituted with imports (See Table 1.3).

Table 1.3. Dynamics of Supply Response	The employment effect 1994-98	Employment Elasticity 1994-98	Productivity of 1988 in thousand dollars	Productivity growth 1994-98	Import coefficient
Manufacturing	529,210	0.94	20.13	6.86	0.58
Food and kindred products	19,795	0.91	26.46	10.44	1.32
Tobacco products	-2,049	0.74	36.95	36.02	0.55
Textile mill products	11,800	0.93	11.61	7.96	2.32
Apparel and other textile products	148,779	1.13	8.36	-11.75	0.83
Leather and leather products	-2,273	0.86	10.87	16.14	0.16
Lumber and wood products and furniture	12,585	1.05	11.85	-4.39	0.49
Paper and allied products	4,266	0.87	23.39	14.38	0.57
Printing and publishing	-7,865	0.90	13.39	10.93	0.45
Petroleum and coal products	4,078	1.15	29.82	-12.74	0.8
Chemicals and allied products	-1.031	0.81	44.06	23.42	0.7
Rubber and miscellaneous plastics products	21,801	0.91	12.60	9.44	1.58
Stone, clay, and glass products	-17,481	0.85	31.08	18.18	0.17
Primary metal industries	4,219	0.75	67.32	32.86	0.14
Fabricated metal products	8,043	0.82	14.72	21.26	0.14
Industrial machinery and equipment	41,117	0.81	17.17	23.37	0.11
Electronic and other electric equipment	150,104	0.88	13.51	13.31	0.04
Motor vehicles and equipment	105,083	0.95	26.41	5.16	0.17
Other transportation equipment					
Instruments and related products	-5,502	0.90	15.53	11.06	0.9
Miscellaneous manufacturing industries	33,741	1.06	14.77	-5.26	1.39

Source: Own estimates based on INEGI, National Accounts System

1.2 Mexico growth paradox

Increasingly dual economy, concentration of export-driven growth in few firms and regional gap in private sector dynamism is both as a problem and an opportunity. Unleashing dormant dynamism of less developed states and SMMEs, generates large development impact (see, for instance, box 1 on supplier development). In Mexico, the regional and sectoral gaps are large and growing. But these gaps present an opportunity for action, an opportunity which innovative local private-public partnerships became to take advantage of but it still remains largely unrealized. This is a Mexico growth paradox: extraordinary dynamism of string economic agents, dormant dynamism of weak agents and states and opportunity for the weak to catch up with the strong.

Where innovative private-public partnerships pushed for better business environment, this opportunity became a reality, but in many Mexican locality the private dynamism is still dormant.

1.3 Regional outcomes of liberalization: Regional growth trajectories

Regional change in the 1990's was linked to a cross-country re-industrialization process. In 1996, thirteen states reached a manufacturing share of GDP above 20 percent, with two of them above 30 percent. Some regions were not able to capture this dynamic and their share was below 5 percent, i.e. Baja California Sur, Campeche, and Oaxaca. Additionally, one group remained in the middle at between 8 and 19 percent. This shows a variety of regional diversity where industrialization is still being debated, and remains the main reason for improving the well being of most of the regions in Mexico. The regions with a high share of manufacturing in GDP were also the states having a more rapid growth rate than the national average and where entrepreneurship was more dynamic as well. As Table 1.4 shows, these include Mexico State, Jalisco, Guanajuato, Puebla, and Nuevo León. This re-industrialization within specific regions helped the country develop a new manufacturing culture among policy makers at the regional level. The different regional governments were willing to promote industrialization, choosing the maquila type of industrial organization—as was the case of Oaxaca, while others chose to strengthen cluster and subcontracting networks as their formula to foster industrialization.

[4] Similar results are obtained by V. Hugo Juan Ramón and Luis A. Rivera Batiz in the IMF working paper "Regional Growth in Mexico 1970-1993". August 1996.

[5] The hypothesis which states cross sectional real per capita GDP dispersion declines over time – known in technical terms as σ convergence – can be denied as the standard deviation increased from 0.40 in 1970 to 0.42 in 1996. With the recent data the absolute convergence β which predicts that poor states would tend to grow faster per capita than rich ones. In turn, poor states tend to catch up with the rich ones in terms of the level of per capita GDP, can also be denied as the richest states were the ones to obtain a larger growth, while low income states such as Oaxaca remained below the average growth rate.

Table 1.4. Industrialization, Entrepreneurship and Growth Trajectories										
	Industry GDP as % of Total GDP	New businesses by region 1993-98	Growth Trajectories 1988-98		Industry GDP as % of Total GDP	New businesses by region 1993-98	Growth Trajectories 1988-98		Industry GDP as % of Total GDP	New business. es by region 1993-98
México	32.8	12,549	127	Guanajuato	19.9	6,685	138	Sinaloa	8.2	324
Coahuila	32.2	832	146	Baja California	19.6	729	167	Chiapas	5.8	1,615
Querétaro	29.8	832	175	Veracruz	19.2	5,747	106	Tabasco	5.5	1,267
Tlaxcala	29.3	2,519	129	Durango	18.5	780	138	Colima	5.3	126
Nuevo León	26.5	2,493	145	Distrito Federal	18.2	878	144	Zacatecas	5.2	547
Hidalgo	26.0	2,012	119	Sonora	17.8	874	137	Guerrero	5.1	5,596
Aguascalientes	25.9	158	207	Michoacán	14.1	4,446	134	Baja California Sur	3.5	70
San Luis Potosí	25.1	956	127	Oaxaca	14.1	6,990	120	Quintana Roo	3.0	331
Puebla	22.7	4,972	149	Yucatán	14.0	-3,626	155	Campeche	1.4	-812
Chihuahua	22.3	804	177	Nayarit	10.5	454	110			
Jalisco	21.4	9,049	128							
Morelos	20.5	1,692	146							
Tamaulipas	20.3	948	147							
Average / number	25.8	39,816	148	Average / number	16.6	23,957	135	Average / number	4.8	9,064
Source. INEGI. Censos Económicos 1999. Resultados Oportunos/Sistemas de Cuentas Nacionales a Nivel Estatal 1996										

This change in the industrialization process was linked to a change in the specialization pattern of each state.[6] Location indices were used to determine the degree of specialization, estimated following this ratio:

$$\text{Location index} = (GDPir/GDPr)/(GDPi/GDPn)^{7}$$

[6] Understood as a change in the dominant industrial sectors in each state.
[7] GDPir = Regional GDP in sector i
GDPr = Regional GDP
GDPi= National GDP in sector i
GDPn= National GDP

The results allowed us to group states in accordance with their specialization index:

Border industrialization:	Baja California, Sonora, Chihuahua, Coahuila, Nuevo León, and Tamaulipas.
Re-industrialization:	Jalisco, Aguascalientes, Querétaro, Guanajuato, San Luis Potosí, México City and environs including DF, Puebla, Morelos, Estado de México, Tlaxcala, and Hidalgo.
Oil states:	Veracruz, Tabasco, and Campeche.
Southern industrialization:	Guerrero, Oaxaca, and Chiapas.
Tourism states:	Yucatán, Quintana Roo, and Baja California.
Raw materials states:	Sinaloa, Nayarit, Durango, Nayarit, Michoacán, Colima, and Zacatecas.

The most successful regions (Northern Border, Industrial Restructuring, and Mexico City and environs) are related to a larger share of manufacturing activities than other areas of the country. Their success is attributed to a larger number of manufacturing entrepreneurs, to a more efficient educational system, to a higher public expenditure, and higher financing flows from the banking system. All these factors have helped attract foreign investment and maquila operations, which in turn have created a larger flow of exports and tourism.. Dynamics in each region have different roots:

Table 1.5. Factors of Growth at Regional Level	Northern Border	Industrial Restructuring	Mexico City and Environs	South	Oil States	Tourism states	Raw Materials	Mexico
Size of the economies								
GDP 1998 Million of dollars	90,709	54,687	154,515	18,792	24,839	12,243	29,115	384,900
Growth of he region (1)								
1970-1980	4.95	6.16	6.94	7.81	10.76	9.45	5.16	6.21
1980-1988	0.61	0.99	0.51	0.28	1.34	1.26	0.60	0.29
1988-1998	1.07	1.10	0.70	0.59	-0.70	1.99	0.56	0.76
Size of population 1998 (2)	16,136,968	15,695,002	30,989,617	10,519,287	9,549,725	2,790,780	10,967,556	96,254,388
GDP per capita 1998 Dollars	5,621	3,484	4,986	1,786	2,601	4,387	2,655	3,294
Growth of GDP per capita								
1970-1980	1.77	2.64	3.11	5.24	6.51	3.02	2.31	6.21
1980-1988	-0.08	0.17	-0.08	-0.63	0.58	-0.21	0.10	0.29
1988-1998	0.36	0.39	0.06	0.00	-1.45	0.78	0.09	0.78
Specialization % of GDP 1988-98 (1)								
Agriculture	8.4	8.2	6.3	15.7	7.5	7.3	19.1	7.2
Mining	2.8	1.0	0.7	1.7	22.0	3.1	3.4	2.4
Manufacturing	24.8	28.5	28.5	9.1	10.3	9.0	12.0	23.6
Construction	3.7	4.3	4.6	4.5	4.4	4.2	4.3	4.1
Utilities	2.0	1.3	1.6	4.0	1.6	1.3	3.6	1.5
Commerce	23.5	22.6	20.9	26.8	26.6	36.5	22.0	23.6
Transport	9.0	9.1	8.5	7.1	6.5	8.9	8.0	8.8
Financial services	11.0	10.7	11.8	12.9	8.5	13.0	11.9	12.1
Social and personal services	16.7	15.7	18.6	18.8	13.5	18.0	17.1	18.7
Entrepreneurship in the regions (3)								
Number of manufacturing businesses 1998	30,756	29,709	40,408	4,250	5,970	3,659	12,189	126,941
Micro	23,841	23,495	29,903	3,916	5,184	3,073	10,650	100,062
Small	4,628	4,857	7,898	262	593	455	1,160	19,853
Medium	1,080	810	1,539	41	102	70	219	3,861
Big	1,207	547	1,068	31	91	61	160	3,165
Employment in the manufacturing sector 1998	1,580,217	754,548	1,343,027	45,200	107,264	72,604	211,172	4,114,032
Micro	96,228	100,889	132,408	11,419	17,361	11,789	36,218	406,312
Small	178,124	179,013	300,845	9,078	21,541	16,575	43,732	748,908
Medium	173,983	124,443	240,115	6,689	14,844	10,995	35,109	606,178
Big	1,131,882	350,203	669,659	18,014	53,518	33,245	96,113	2,352,634
Human capital (4)								
Efficiency of basic education %	51.4	44.2	50.2	26.1	37.8	49.6	40.1	41.8
% of population with secondary education	19.1	12.2	13.8	6.7	10.4	16.9	10.2	12.93
Years of school (Average 1999)	8.4	7.4	7.9	5.9	7.3	7.7	7.3	7.7

Table 1.5. Factors of Growth at Regional Level	Northern Border	Industrial Restructuring	Mexico City and Environs	South	Oil States	Tourism states	Raw Materials	Mexico
Role of Public Sector (5)								
Public expenditure per cápita	587.9	443.6	382.1	462.8	599.3	451.6	381.0	391.56
Public expenditure as % of GDP								
Foreign demand factors (6)								
Number of maquila businesses	2,537	253	191	17	6	96	125	3,100
Maquila employment as % of manufacturing employment 1996	59.3	4.8	1.0	0.5	0.0	7.2	3.8	11.8
Foreign Direct Investment 1994-1998 Million dollars	12,933	1,632	29,037	73	115	414	548	41
State exports as % of GDP 1996	60.1	12.7	19.4	2.4	3.5	4.9	7.5	32.0
Flows of tourism 1988-1996	5.6	14.0	18.4	12.5	1.4	44.0	4.1	100.0
Financial sector role (7)								
Private sector financing as % of GDP 1996	15.5	8.2	8.8	2.6	4.3	8.1	5.6	12.8

Source: (1) National Account System, INEGI, 1997 (2) Statistical Annex, IV Informe de Gobierno, Presidencia de la República, EZPL, 1999 (3) SECOFI (4) Encuesta Nacional Ingreso-Gasto de los Hogares, INEGI, 1998 (5) State and Municipal Finance, INEGI, 1997 (6) Basic maquiladoras indicators, INEGI, 1997 FDI: SECOFI, Tourism by the Ministry of Tourism (7) Statistical Annex, II Informe de Gobierno, EZPL, 1997

In the border states there is an efficient educational system which created the highest average of schooling in the country (8.1 years). This helped to develop entrepreneurship in the region, allowing them to attract foreign investment or maquila operations (Baja California, Sonora, Chihuahua, Coahuila and Tamaulipas) and foster local entrepreneurship (Nuevo Leon). Location under flexible industrial organization has helped to develop in- place sourcing and with it what has been called the "third generation maquila" successfully blending traditional maquila with the engineering activities. The most outstanding example has been Delphi, a former General Motors associate, with more than 50 plants in the rest of the country. Delphi has become the second largest employer of the country, second only to Pemex. This dynamic has promoted a competitive culture, fostered exports, and generated a process of integration with the southern United States.

In reindustrializing states local governments were able to set up a new type of industrial promotion with a clear orientation toward competitiveness. Government programs here are the largest in the country, supporting businesses with a network of services and providing subsidies to low-end SME producers and traders, as is the case of the program for microenterprise in Jalisco and the Sta. Fé program in Guanajuato which supports trade at low-end levels. Supporting services for medium-end producers had focus on the development of clusters and services to upgrade their competitiveness. High-end producers have been helped by the promotion of foreign direct investment and maquilas, developing clusters and subcontracting networks, i.e. Jalisco, enabling them to develop an auto parts cluster, combined with an electronic network, where IBM, Hewlett Packard, Motorola, and Lucent Technologies attracted Asian suppliers. This state not only was able to develop FDI clusters, but also to modernize its traditional industries – apparel, shoes, furniture, and jewelry. Aguascalientes was able to develop an auto cluster with Nissan and its suppliers, bringing in the maquila-like Texas Instruments and Levis. Guanajuato renovated its shoe industry, combined with the development of an auto cluster with General Motors in Silao. Queretaro was able to attract foreign direct investment with its industrial park policy bringing in FDI in different sectors: Delphi, Clarion, Daewoo, Kellogg's, Kimberley Clark, New Holland, and Black & Decker among others. Finally, in the same group is San Luis Potosí that attracted FDI in electronic appliances and apparel maquila.

In Mexico City and metropolitan area there was a renovation of the industrial capacity due to the environmental rules set for the whole region. In Tlaxcala, Hidalgo, and Morelos maquila clusters were created. In Hidalgo, the Canadian Bombardier attracted large suppliers creating a metal mechanics cluster, and Tlaxcala and Morelos were able to develop an apparel network. Within the region there developed an exchange of businesses, as Distrito Federal is becoming a service center, causing manufacturing activities to extend outward to nearby locations.

Less developed regions are the following:

States where tourism is a determinant for growth are located in the Yucatan peninsula and Baja California Sur, where the number of foreign visitors between 1988 and 1997 increased from 1.092 million to 3.361 million. In the 1990's the Yucatan's government developed a very successful policy which promoted foreign investment and maquila, causing maquila units to increase from 10 to 132. This created 26,000 new jobs in the decade. Tourism and maquila could help this state to develop in-place suppliers who in turn could foster the development of remote regions in Quintana Roo.

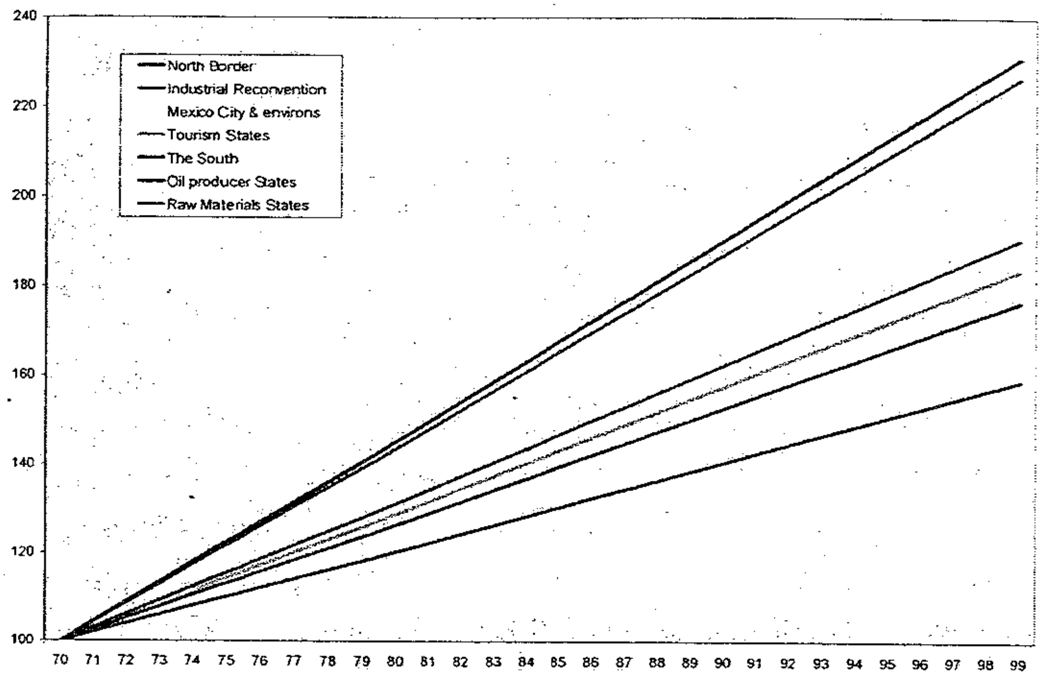
Oil producing states (Campeche, Tabasco, and Veracruz) had not been able to develop in-place suppliers, relying instead on imports from the rest of the world and from other regions. In fact, Campeche has the lowest number of entrepreneurs in the country. The potential of this region is impressive, not only from oil resources, but also from the agro industry. Campeche has recently established a program "Transformando Campeche" whose aim is to promote manufacturing and service activities in the region. Veracruz is better endowed to foster industrialization as it already has the largest petrochemical complexes in the country and has been able to develop a metal mechanic cluster around the oil industry, such as TAMSA – a metal tube producer.

In low income states (Oaxaca, Chiapas, and Guerrero) where public investment and expenditures was a key factor there is lack of entrepreneurial development, causing public expenditures to be the economic driving force. Agro industries have not been able to upgrade to world class status. Large conflicts in the area caused them to look for larger government support as is the case of coffee producers in Chiapas. During the 1990's, Oaxaca pushed to develop an apparel cluster of maquila that is still reduced and with non backward linkages, but that has allowed manufacturing to rise from 6 to 14 percent between 1988 and 1996.

States where reliance on agriculture and forestry remains high had a very heterogeneous behavior. Sinaloa has developed high quality agriculture and fisheries industries, but has not been able to develop in-place suppliers for shipbuilding and maintenance. Michoacan (a rich agro producer) has not been able to increase competitiveness of traditional industries, as is the case of the furniture industry. Durango has a similar problem with it's furniture industry. Zacatecas has kept its wine network and has been able to attract some apparel maquila as well. The lagging state of Nayarit (a traditional grain and sugar cane producer) has been unable to develop an entrepreneurial base.

To sum up, one has seven regional growth trajectories. Border and Re-industrialization states have had the most successful trajectory, while Southern and Raw Material states had the least dynamic manufacturing trajectories. As can be seen in the following graph, all the other regions are in the middle of this spectrum.

Figure 1.3 : Manufacturing Trajectories 1970-1998
(Annual growth rate 1970 = 100)



Some regions have been more successful in promoting public-private cooperation, making it possible for certain regions to find a combination of programs whose interaction creates a feedback mechanism for industrialization. The following chapter will address public-private problem solving at the state level.

Chapter 2: Emergence of a Decentralized Model of Promotion

2.1 Evolution of Institutional Infrastructure

In the previous chapter, we identified a series of patterns of economic development throughout various states of the Republic. We turn here to an exploration of three of those patterns through more intensive case studies in the states of Aguas Calientes, Chihuahua, Jalisco, and Michoacan. In each of these states, the development process centers on manufacturing industries. As a group they represent a contrast to other patterns, which we identified, that are more closely linked to a natural resource base such as oil, agriculture, or tourism. But the type of manufacturing development in each of our case studies is different: Aguas Calientes and Chihuahua are areas of new development; Jalisco combines both new industrial development and traditional industries; and Michoacan is an area of traditional development. We will show that these differences reflect not only an inheritance from the past, but also the different public policies that the states have pursued in recent years.

Table 2.1. Profile of Case Studies

	Jalisco	Chihuahua	Michoacán	Aguascalientes	Mexico
Size of the economy (Million dollars of 1996)	19,224	12,657	6,927	3,297	300,234
Income per capita - dollars of 1996	3,209	4,531	1,790	3,822	3,294
Manufacturing as % of 1996 GDP	21.65	23.23	13.31	26.64	20.28
Manufacturing Employment 1998 - persons	328,382	348,266	87,918	70,700	4,213,566
Manufacturing businesses units 1998	29,792	8,749	20,465	3,859	361,579
FDI million dollars 1998	228.5	571.4	1.6	50.8	4,470.6
Productivity in thousands dollars of 1998	5.7	3.9	4.9	5.8	6.8
Public Expenditure per capita dollars of 1996	614.66	486.12	292.85	419.65	391.56
Gini coefficient 1996	0.555	0.515	0.469	0.402	0.489

Source: For economic size, GDP per cápita and manufacturing as % of GDP, Sistema de Cuentas Nacionales de México, INEGI, 1997. For FDI and Exports SECOFI. For Public Expenditure State and Municipal Finances, INEGI, 1997. For Gini Coefficient National Survey of Family Income and Expenditure, INEGI, 1998. For productivity, manufacturing employment and business units Censos Económicos 1999. INEGI.

Two states, Chihuahua and Jalisco, present a contrast in terms of relative success. They have been among the most successful states in terms of the increase in per capita income and the transformation of the industrial base in the face of the reorientation of the Mexican economy. Michoacan, on the other hand, has failed to adjust to the new economic context and income in the state has tended to stagnate.

Our case studies need to be understood against the background of the broader pattern of Mexican development. In the last twenty years, that pattern has shifted dramatically. This change has had five distinct and important, although interacting, dimensions.

The first important dimension was the opening to trade itself and the exposure of firms that had previously operated in a sheltered domestic market to international competition. The second dimension of the new development strategy was a shift in federal government policy from one of active involvement in micro-economic management to one of determined laissez-faire. As a result, firms, which had become accustomed to looking to Mexico City for both general direction and specific support, found themselves facing the pressures of the international marketplace on their own. The federal government has remained very active in the management of macro-economic policy. It also retained a panoply of specific programs and policies inherited from the previous era. But these programs have not been organized and directed in a concerted way toward helping the economy adjust to the new environment. Rather, their administration had been left to lower level bureaucrats and party functionaries in accord with traditional clientelistic practices. The better trained and most talented government officials have concentrated on macroeconomic management, the negotiation of international treaties designed to open the economy, and the process of government withdrawal and retrenchment through privatization of state enterprises.

The third dimension of the new strategy , in some ways the byproduct of the first two, was the deterioration of what might be called the <u>institutional infrastructure</u>. This is the connective tissue of institutions and personal relationships governing the economy at the local and industry level thus enabling the various economic actors to work together **in a** concerted fashion. It can be argued that both the institutional infrastructure in Mexico under the old development strategy was already weak and deficient, and that the active role of the federal government and its position in the economy had substituted for social relations and local institutions which might otherwise have developed. But such relations had nonetheless played a more important role than was otherwise apparent and the pressures caused by the opening to trade strained them to the breaking point.

Fourth, these effects were further aggravated by the collapse of the banking system. In a sense, the banking system can be considered one of the key elements of the institutional infrastructure of any economy. In Mexico, two separate factors made it less and less viable in providing the connective tissue of the local economy. One was the process of nationalization and then of subsequent denationalization, whose end result was the disappearance of local banking and the centralization of banking in Mexico City. This occurred at the very time that the pressures of economic adjustment were toward a decentralization of production and its dispersion away from the Federal District and the surrounding states. The second element of the banking crisis was the way in which macro-economic management produced an extreme shortage of capital, especially working capital. One of the results was that companies were forced to look to the United States for working capital and often found it by entering into dependent maquila relationships with U.S companies whose suppliers then extended credit to Mexican firms. The net result of these factors left t firms, which previously had very little exposure to the international marketplace, to fend for themselves. They were forced to adjust to a completely new, and unfamiliar economic environment at home and in the international market place without the assistance of the federal government, without adequate credit or local banking support, and without the infrastructure of institutional and personal supports from other economic actors and organizations which had functioned in the preceding regime.

Some Mexican companies have managed this process quite well and emerged as world-class producers. Overall, however, Mexican producers had trouble meeting international standards of quality and reliability, let alone creating new, fashionable or technologically advanced goods and services. This has not only hampered their ability to export; it has also make it difficult for Mexican firms to hold on to the domestic market. Even traditional labor-intensive industries such as shoes, clothing, and furniture, which should have had a comparative advantage as the low-wage sector of the newly unified North American market, have lost ground.

Box 2.1 Devolution of Institutional Infrastructure

The best-documented example of the way the institutional infrastructure was impacted by the adjustment process is the structure governing the shoe industry in Guanajuato. The Camara of shoe producers in the state organized the industry in the postwar period, developing a system where retailers could verbally order in advance and payment was guaranteed, even if the prices changed in the interim or the shoes, when they arrived, did not sell. Retailers were able to return defective merchandise and the Camara would manage a system for the adjudication of disputes. The system was backed by the power of the association. All members boycotted any retailer who broke the rules under which the industry was governed hence effectively cutting off violators from all supplies. The system operated to allow producers to plan production in advance and smooth the production process. But with the opening to trade, the retailers found themselves able to order directly from foreign producers. The inhibition against reneging on commitments disappeared, traditional channels of distribution were completely disrupted, and for a period the Camara itself fell apart, and the individual producers were left to face, on their own, the adjustments already demanded by foreign standards of quality. Ironically, the opening itself undermined the institutional structures, which had supported these Mexican characteristics that foreign buyers found most wanting, namely reliability.

A somewhat different example of the impact of trade on the social infrastructure of traditional industries is the furniture industry in Ciudad Hidalgo in the state of Michoacan. There we visited a group of firms that had organized a small association (an integradora) to help them strengthen their competitive position and recapture the domestic market. The members of this association were all small family enterprises, which in many ways is typical of firms in countries at the brink of industrialization. The firms extended beyond the family in the sense that they all had from five to as many as twenty employees, but they were not completely separated from the economics of the household. Production took place in or near the house of the owner. Capital and family finances were intermingled. In several cases, the house had been mortgaged to finance the business. In one case, the owner had lost his house and his family had been forced to move into the factory. In another case, a medical emergency in the family had depleted the working capital of the most innovative company in the group and driven it to the verge of bankruptcy. The workshops were full of children, ranging in age from infancy to adolescence, who were there not as part of the labor pool but rather as in a daycare situation. As these children grew older they were increasingly drawn into production, but were never really productive assets as the distraction of caring for the younger children cost as much in productivity as the value of work added by the older children. The shops were not laid out in an efficient, rational model but reflected the construction of the house and outbuildings that had been designed for other purposes. This layout, the presence of young children, and the overall lack of fixed capital investment which was dedicated to production, were obviously important factors in the underlying problem of quality and reliability which handicapped the industry in international competition and increasingly in the domestic market as well.

Box 2.2 Institutional Infrastructure Seen Through the Eyes of Small Furniture-Maker

A somewhat different example of the impact of trade on the social infrastructure of traditional industries is furniture in Ciudad Hidalgo in the state of Michoacan. We visited a group of firms there which had organized a small association (an integradora) to help them strengthen their competitive position and recapture the domestic market. The members of the this association were all small family enterprises, in many ways typical of firms in countries at the edge of the industrial era. In particular, the firm extended beyond the family in the sense that they all had from five as many as twenty employees but the businesses were very incompletely separated from the household economy. Production took place in or near the house of the owner. Capital and family finances were intermingled. In several cases, the house had been mortgaged to finance the business. In one case, the owner had lost his house and his family had been forced to move into the factory. In another case, a medical emergency in the family had depleted the working capital of the most innovative company in the group and driven it to the verge of bankruptcy. The workshops were full of children, but the children were there basically so that their parents could take care of them while working. They were drawn increasingly into production as they grew older, but were not really productive assets; the distraction of caring for the younger children must have cost as much in the productivity of the enterprise as the work of the older children added. The shops were not laid out in an efficient, rational model but reflected the construction of the house and outbuildings which had be designed for other purposes, and the layout, as well as the children and the overall lack of fixed capital investment dedicated to production, were obviously an important factor in the underlying problem of quality and reliability which handicapped the industry in international competition and increasingly in the domestic market as well.

The traditional industry had however clearly been embedded in a broader institutional infrastructure. One component of that infrastructure as an informal social code which governed the role of children in the industry and protected them from being drawn prematurely into production. Another was a local banking system staffed by people from the region who know the families personally and the firms historically and were able to make reasoned judgments about risk without the formal accounts of modern business.

Under the pressures of international competition, however, the firms have been forced to intensify work. The line between the household and the business shifts almost imperceptibly. As the intensity of work increases, the parents are too busy to pay attention of the very young children and the old children are drawn prematurely into production. The social control breaks down and what was basically a symptom of the household in the shop becomes abusive child labor. At the same time, the pressures of the market force the firm to draw more and more heavily on household economic resources in ways which would have strained the old banking system had it survived, but in addition the collapse of local banking has make the business even more dependent on the family. We actually encountered one family which had been forced to move into the factory the house which it had mortgaged to finance the business was reprocessed. The fact that the family was living in the shop, of course, aggravated further the problem of abusive child labor and of quality and reliability in production.

To address these problems, you would actually have to reorganize production, remove it from the household, and take the children out of the shop. **All of this requires a different institutional infrastructure**. The local banking system might not have to be changed, just restored. But you would certainly need to create schools and daycare for the children if they were removed form the workplace. And an infusion of long term capital is probably necessary to reorganize production and place it in a location where the layout can be dictated by efficiency considerations alone. This in turn requires financial arrangements which go beyond the personal savings which have been used to finance the expansion historically.

In the face of the collapse of traditional industry, the adjustment to an open economy is taking place through heavy reliance upon direct foreign investment and upon the maquila industry. The latter essentially takes advantage of low-wage Mexican labor while importing virtually all of its other inputs from abroad and exporting their output. The foreign firms involved in these maquila relationships closely supervise their Mexican partners and actually forbid them from using long chains of Mexican subcontractors. Foreign direct investment operates very much like the maquila sector, relying heavily on imported inputs. When foreign direct investment does use Mexican suppliers, they tend to be foreign companies (which they often induced to locate in Mexico along side them) rather than native firms. Successful Mexican firms have a similar tendency to cut themselves off from the rest of the Mexican economy, relying, like foreign firms, on imports and/or providing goods and services internally through an organizational strategy that involves extensive vertical integration. In this regard, Mexican companies appear to be going against trends in business organization which are away from internal integration toward a focus on core competencies combined with heavy reliance on other organizations through strategic alliances and highly co-dependent contracting arrangements. Against these trends the integration of the successful Mexican companies appears to be excessive (Box 2.3).

The problems with this development pattern are twofold. ***First, because successful producers in Mexico have few backward linkages with the rest of the economy, they are attracted to and held in the country by the low cost of the basic factors of production, principally labor. They could easily leave the county and locate elsewhere if relative factor prices were to shift. In this regard, Mexico's current development is fragile***. The fragility is suggested by the experience of other places that have also relied on maquila-type development. The pioneer of development as a low wage enclave within the U.S. market was the Island of Puerto Rico. The Island took advantage of its status within the U.S. customs area and its low wages to attract branch operations of American corporations. It levered the effects of low wages through fiscal incentives and subsidized plant locations. It is through this policy that Puerto Rico grew, in the course of the 1950's and 1960's, to become the highest per capita income territory in Latin America. But this growth was not without a downside, namely, the demise of it's traditional industries. Small-scale

Box 2.3 Excessive Vertical Integration

Emblematic of this process is the GFT men's clothing plant in Cuernavaca. GFT Mexico is one of the leading world producers of quality men's clothing: it has been very successful in exporting to top of the line department stores in the United States. In virtually every country in the world, and in other parts of Mexico, there is a sharp division between the textile industry, which has large integrated, and highly capital-intensive, production facilities, and the clothing industry which is extremely labor-intensive and easily broken up into a series of separate and distinct operations which can be subcontracted to take advantage of differential skills and labor costs. GFT is one of two plants in the world that is totally integrated; inputs in the form of wool and other raw materials enter the plant and finished suits emerge. The only operation in the whole facility which is subcontracted is the highly labor-intensive work of viewing the finished textiles for defects and correcting them by hand before the material is cut into components for the suit.

The tendency toward virtual integration is by no means confined to very large Mexican companies. In San Lorenzo, in Michoacan, we interviewed a relatively small food processing company which had been very successful in exporting melons and avocado products, and more recently exotic fruits, to the United States and Europe. The firm prided itself on being completely self-sufficient. It used processing equipment from the U.S, France, Italy and Germany, but it maintained and repaired the equipment itself, without the help of the vendors, and its craftsmen were capable of actually building the equipment in house. Although the company's "core competency" lies squarely in food processing, it makes its own plastic packing boxes and runs its own transportation system. There were some signs of a more open, cooperative approach among newer avocado producers (see Box). And the CEO of this established company recognized that this organizational pattern was totally outdated and had to change. But, significantly, he was unsure how rapidly he could open up the company, both because the old line management was reluctant to change and because it was difficult to find reliable outside firms with which to cooperate.

agricultural producers could not meet the standards of quality, reliability, and minimum order size of U.S. supermarket chains, which had come to dominate the Island's retail trade. The rapid urbanization and development produced an escalation in land values which squeezed the traditional agricultural export industries: sugar, tobacco, and coffee. These industries were also plagued by increasing labor shortages, despite continuing high unemployment and government wage subsidies, as this work came be viewed (when contrasted to factory labor on the Island or as migrants in the continental United States) as socially degrading. The local business elite profited enormously from the rising land values, but invested those profits in a diversified portfolio of U.S. assets rather than in productive assets on the Island. During the 1970's and 1980's, Puerto Rico began to lose its locational advantage as other locations in the Caribbean Basin with still lower wages gained privileged access to the U.S. market and branch plants abandoned Puerto Rico. As a result, the rate of growth has slowed and the Island economy has become increasing dependent on migrant remittances and government transfers.

Second, firms do not learn from each other. Mexico is developing a dual economy. One sector is becoming well integrated in international capitalism (principally by attaching itself firm by firm to the economy of the United States) buying its inputs abroad and exporting much of its output. The other sector remains tied to traditional ways of doing things, and is having an increasingly hard time surviving on any terms as retail trade in Mexico is more and more dominated by imported products and international retail outlets. The advanced sector has little spillover into the backward sector, thus increasing the disparity of income in the country and creating stronger and stronger barriers to social mobility. Such an economy is, moreover, difficult to manage from a macro-economic point of view and tends to be relatively unstable, since any attempt to devalue the currency to stimulate exports results in an increase in the cost of inputs, which are imported, from abroad.

The developments in the three states upon which we focused our case studies very much reflect this pattern. The success of Jalisco and Chihuahua has been highly dependent upon attracting direct foreign investment from large, multinational firms. Traditional industries in Jalisco were very hard hit by the opening to trade and, until quite recently, tended to stagnate and decline. Traditional industry in Chihuahua was closely associated with primary production and has maintained the advantage of its natural resource base, but, as earlier in Puerto Rico, large landholders have tended to move out of agriculture and turn their attention instead to the real estate speculation occasioned by the influx of foreign producers. Both states, however, have become extremely conscious of the limitations of this development pattern. Jalisco and Chihuahua have moved both to revive traditional industry and to encourage the development of backward linkages from foreign firms that would anchor them in the state and spread the foreign know-how more broadly in the local society. The effort to revive traditional industry in Jalisco has actually been quite successful. The success of these efforts in Chihuahua is more problematic, and in both states the development of a local base of suppliers is still elusive. Nonetheless, both states stand in sharp contrast to Michoacan, which has not attracted direct foreign investment or any secondary development as a result of subcontracts from investments made elsewhere in Mexico, and where traditional industry was very hard hit by foreign competition and shows absolutely no sign of recovery. Michoacan presents a sharp contrast to the other states in terms of the absence of policy initiative in these areas as well.

2.2 Understanding Structural Adjustment and the Institutional Infrastructure

Two analytical constructs drawn from management science and development studies are particularly useful in thinking through the question of inter-firm linkages. The first is that of a supply chain, or a value-added chain. The second of these is the notion of clusters: inter-firm networks and industrial districts. These two types of concepts are often used together in the literature. They share the notion that economic activity is not coordinated solely through signals generated by and communicated through an impersonal marketplace. It involves direct coordination through face-to-face communication. But the nature of the coordination they envisage and the kinds of relationships (or institutional linkages) that are required for it to take place are very different. Both have actually played a role in the development process itself since state level officials and, more importantly the consulting firms they had hired, use them. Policymakers in both Jalisco and Chihuahua drew upon them explicitly. But they are also helpful in understanding how these local economies are evolving.

The value-added chain suggests that it is useful to think of industrial development in terms of a sequence of interdependent activities linked together in a vertical chain ranging from raw material production at one end to the delivery of final goods and services to the consumer at the other. These chains tend to be defined in terms of products – the automobile chain, the garment chain, electronics, and pharmaceuticals. The conventional economic analysis would treat each link on the chain as producing a separate commodity with a general market spanning a variety of industries and perhaps geographic locations. The value-added chain approach, however, views the production process as requiring more highly specialized inputs which need to be designed to fit together in a highly integrated fashion. A value-added chain typically crosses a variety of different industries, but each stage is much more closely linked with upstream and downstream positions on the chain than with other producers in the industry. Thus, automobile production requires specialized steel, glass, rubber, and specialized parts, and the final product is sold through specialized dealers. Similarly, blue jeans require specialty textiles (denim), are sewn in dedicated shops, and they too are often sold through specialty stores. Because the pieces are so specialized, the chain requires close administrative coordination. In the past, that coordination might have been achieved within a single integrated organization. The leading example of such an organization is Ford's River Rouge plant, where steel entered at one end and cars came out the other.

Such a geographic and organizational concentration is in today's world extremely rare (that is one of the reasons why Mexican companies appear to have a distorted organizational structure). Nonetheless, coordination is not achieved through an impersonal market. Most versions of this theory recognize that there are certain positions along the chain that exercise considerable power over the whole chain of operations and are essentially responsible for holding the chain together and directing its evolution over time. In the automobile industry, power resides in the major assembly firms. In the garment industry, at least in the United States, it increasingly resides in the retail firms like J.C. Penny's or The Gap. The question of why power is to be found at a particular point in the chain and how it shifts over time is a central issue in research organized around this concept.

The value-added chain is one of vertical linkages. The "industrial district" or cluster thinks about the development process in terms of horizontal linkages among firms. This idea can be traced in the literature to Alfred Marshall's notion of the "industrial district". This concept was revived and expanded to explain the pattern of development in central Italy. Previously, central Italy was characterized by a series of small cities each of which specialized in high value-added products ranging from specialized industrial equipment and medical devices to high fashion luxury goods in textiles, clothing, footwear, and furniture. Again, the contrast is to the market where coordination is impersonal. The districts involve external economies, basically relationships that do not go through the market and are not reflected in prices. The firms do not enter the market as independent, autonomous producers but rather are dependent upon a series of relationships with each other. These relationships involve the sharing of technology, of a particular style or approach to design, and a pool of resources, which support them. But the actual relationships among particular firms within these communities have little permanence or stability. There is a continual change in the firms which are working together, and the roles which a particular firm plays, tends to shift from one relationship to another. Also in contrast to the value-added chain, it is very hard to identify a particular center of power and administrative direction. Nonetheless, the sense of community is important in holding the agglomeration together and the question of how such communities are created and maintained over time is in many ways the central research question suggested by this analytical construct. There is a tendency to think the glue that holds together an industrial district is social, and the term "social capital" appears frequently in this literature. Whereas the glue that holds together the value-added chain tends to be technological.

While the two concepts are analytically very different they share the common notion that the production process cannot be understood through a market mechanism. In a sense, they constitute competing alternatives to the market, not simply conceptually but in point of fact. Thus, in high fashion garments, one can argue that the industrial districts of central Italy (or New York, Paris, and Tokyo for that matter) compete with the value-added chain directed by the major retailers such as J.D. Penny's and The Gap.

2.3 Emergence of an Industrial District: Lessons of Aguas Calientes

To get a better grasp on how to unleash private sector dynamism, let us examine a story of the Asian tiger within Mexico -- the state of Aguas Calientes. In the last decades, the state of Aguascalientes, around 250 miles north of Mexico City and 800 miles south from the Mexico-US border, has experienced an extraordinary performance in terms of economic growth and development. The state is one of the smallest in the country with 851,000 inhabitants in an area covering only 0.3% of the national territory. Traditionally and up to the late 1970s, Aguascalientes' economy had relied primarily on agriculture , complemented with some production of wine and garments (as the nearby States of Michoacan and to some extent Zacatecas still do now). This situation has changed radically since the early eighties, a period of fast industrialization in which Aguascalientes, has experienced rates of growth in both manufacturing and exports which far exceeded the national average. This growth has largely been fueled by considerable amounts of foreign direct investment (FDI), particularly from the Japanese automobile and U.S. electronics industries. How did this extraordinary growth come about?

Self evaluation of needs, weaknesses and strengths of the private sector

In 1974, the incoming state governor decided to pursue a radically different development strategy during his tenure (1974-1980), and shift emphasis from agriculture to manufacturing. Given their limited experience in Industrial Promotion, their first action was to determine the main needs of industry. This was done by asking the owners of what were then the strong productive sectors: agriculture, winemaking, textile, garment, railroad repair, and some metal-working. Similarly, they contacted unions to understand the main concerns of labor. The results of their initial survey were not encouraging, for they realized that the state lacked important conditions to attract investment, particularly basic infrastructure.

Improving business environment for 'first mover' firms – an industrial park

In 1973, Nacional Financiera (NAFIN, the federal industrial development bank) decided to support the development of medium cities in 23 states as part of the National decentralization program. This program included the creation of Industrial Parks which provided physical infrastructure, business development services, plus a very wide array of support mechanisms such as fiscal incentives and project evaluation assistance. The state government took advantage of the program by creating a trust for the Industrial Park of Aguascalientes, and donated 200 ha., 40 of which were urbanized with the support of NAFIN.

Firms invest, private industrial parks flourish, the image of the State changes

The effort to strengthen the necessary infrastructure and services soon resulted in new investment for the state and a broadening of the local manufacturing base. Among the key firms established in the later part of the seventies are three national metalmechanics firms , and the first automotive components firms. Since the first industrial park was so successful in attracting industries, the trust funds have been used to build 3 more parks from the seed capital of the original industrial park. These years of the industrial development can be considered extremely successful in at least three ways: First, the creation of important parts of the necessary infrastructure prepared the basis for coming investment. Second, the creation of important networking institutions, such as chambers, where managers gather to exchange points of view facilitated problem-solving and dispute resolution. Third, a change in the image of the state: Aguascalientes was no longer perceived by the rest of the country as an agricultural state, but started building its reputation as an industrial state. The critical mass of suppliers and buyers present, resulted attractive for firms searching for an adequate plant location.

Multinationals respond

The first international project was Texas Instruments (TI) which started exploring options for a manufacturing plant in 1979. The government saw having the plant in the state as a priority, and worked to address legitimate concerns of the TI. For instance, the waiver was obtained on the limitations on foreign ownership (which were typical during the Import Substitution Industrialization era), having to get direct approval from the president. Other key that attracted a first multinational to Aguascalientes was the stability of the labor force, high quality of workers to perform very detailed work (resulting from the embroidery tradition of the past) and high participation of women on the labor force, particularly important for the electronics industry.

First 'shaker and mover' comes, others follow

Once TI decided to settle in Aguascalientes, Xerox and Nissan soon followed. The three major multinational firms have all played an important role in the local economy by giving their employees access to a global knowledge network, plus contributing with the technology which comes embedded with advanced manufacturing processes. In terms of R&D capabilities, all of them develop their product and process technology in their home countries, where they tend to centralized the R&D function (though Xerox has locally developed some product lines).

Today's challenge: linkages to local SME suppliers from the multinationals

Even though both government and firms have actively pursued vendor development programs, the amount of inputs provided by local firms is still quite small. This is the current challenge.

From vicious circle to virtuous spiral of institutional development

Before the transformation had begun, Aguas Calientes experienced a vicious circle of low expectations, low demand for institutional change and thus low investments and outcomes. Concerted private-public effort resulted in a virtuous spiral of better investment environment, institutional reform and enhanced private dynamism. The key institutional features of this transformation: focus on improvement of business environment, private-public partnerships to solve specific problems of business, effective local economic development agency and effective public sector entrepreneur (an extremely dynamic individual with the ability to listen to the private sector and gets things done in most difficult circumstances) are key to unleashing private dynamism almost everywhere.

Focus on investor-friendly business environment

What makes business to invest in a given locality? Attractive business environment – institutional factors affecting risk and returns of an investment project. Instituto Tecnológico de Estudios Superiores de Monterrey (1997) has develop a model of business localization based on Porter model which considers 8 groups of variables:

- Human resources
- Physical infrastructure and market access
- Quality of life
- Regulatory environment (costs of entry, exit and doing business)
- Technological development
- Suppliers and services
- Market conditions
- Investment promotion policies by state government[1]

[1] State government investment promotion consider the evaluation of 12 variables: (i) State control of monopolies, (ii) Incentives for entrepreneurial activity, (iii) Incentives for exports, (iv) Education expenditure, (v) State and local taxes, (vi) Employees of the public administration, (vii) State government corruption level, (viii) Justice and equity, (ix) State government economic plans,

o *Business climate ranking by states*

Table 2.2 shows an aggregated ranking of Mexican States indicating the investment climate and attractiveness of each of them. However subjective these rankings might be, they provide important information on the relative position of different states, and therefore, a approach to the degree of competitiveness of various geo-economic urban clusters, an indication of the transaction costs levels they bear. Predictably, the stellar growth performer Aguas Calientes, is at the top of the league while the South-Eastern states with dormant private dynamism are at the bottom of the Table.

Table 2.2 Business Climate Ranking by States

State	Average classification	Rank
Aguas Calientes	7.06	1
Chihuahua	7.06	2
Querétaro	6.67	3
Baja California	6.62	4
Colima	6.47	5
Guanajuato	6.43	6
Veracruz	6.39	7
Jalisco	5.78	8
Tlaxcala	5.73	9
Morelos	5.64	10
Quintana Roo	5.44	11
Coahuila	5.31	12
Sonora	5.18	13
Tamaulipas	5.14	14
Michoacán	4.94	15
Puebla	4.90	16
Yucatán	4.82	17
Oaxaca	4.82	18
Zacatecas	4.82	19

(x) Economic Development Secretary schemes of support, (xi) availability of strategies for economic growth and, (xii) Environmental and ecological restrictions.

State	Average classification	Rank
Hidalgo	4.72	20
Durango	4.58	21
Tabasco	4.54	22
Campeche	4.47	23
Nuevo León	4.46	24
México	4.12	25
Sinaloa	4.12	26
Baja California Sur	3.92	27
Guerrero	3.83	28
Nayarit	3.79	29
San Luis Potosí	3.65	30
Distrito Federal	3.49	31
Chiapas	3.21	32

Source: Investment Attraction in Mexico. Index for business localization. Tecnológico de Monterrey, 1997

Entry points to improve investment environment and competitiviness

In fostering private sector development, the central challenge for the Mexican government and for the World Bank group is to identify and implement interventions that can initiate and sustain the virtual spiral of better state institutions and enhanced private dynamism. To unlock the virtuous spiral of institutional development, it may be useful to put special emphasis on tangible (concrete, visible) initiatives – **not as a substitute for continuing policy and institutional reform, but as an "entry point" from which systemic constraints can be identified** more specifically, and from which less tangible reforms would follow as corollaries. The government of Aguas Calientes was unusually effective in identifying and implementing such entry points. Starting from private-public industrial parks to more broad-based inditiaves related to reduction regulatory costs of entry, exit and doing business, improvement of infrastructure and human capital. Noteworthy institutional features applicable to other localities are the following.

Catalyst of private-to-private and private-public coordination

The Comision Estatal de Desarrollo Economico y Comercio Exterior (CEDECE) is possibly the most active institution promoting regional economic development. CEDECE has acted as a catalyst of all the other institutions, acting as a bridge and information broker. Bridging functions are necessary between a wide variety of agents: government and firms, federal and local, firms and universities. CEDECE operated previously as a Secretary of Economic Development, however it has become a Commission in order to work closer to firms and more independently from the state government.

Public sector entrepreneur

A new collaborative pattern of actions was catalyzed by small group of dedicated individuals -- champions of change (led by the General Director CEDECE Carlos Lozano) who created and then broaden a network of private and public actors involved in cooperative problem-solving. This individual seems to represent a new institution of public sector entreprenuership responsible (and accountable!) for innovative solutions to improve investment environment and competitiveness.

Learning from success: think locally, act globally

Stunning transformation of Aguas Calientes has generated a lot of interest from less developed states to replicate success. If Aguas Calientes which private sector was as developed in the 70's as private of neighboring and still lagging Michoacan or Zacatecas, why other states can not repeat its success? Every states shall certainly strive to improve its investment environment. Yet there is no magical answer on how to do it: where to start, how to proceed and sequence the efforts. In some states, there is virtually no constituency for reform of investment environment and the primary task is consolidation of such constituency for reform. Because of regional diversity, entry points must vary from state to state. Industrial parks could have an adequate entry point for Aguas Calientes in the 70's, yet this is hardly a good entry point in the modern Mexican economy. Private-public programs tailored to local circumstances but informed by global realities is the order of the day.

2.4 Explain ing the Cases: Specific Policies

How does one understand these developments? The material we gathered suggests that one might think about them in three different ways. First, one can think about them in terms of the specific policies which the states have pursued (or in the case of Michoacan, failed to pursue). We approach the problem in this way in this section of the report. In the subsequent section, we look at these polices from the point of view of the individual firm, drawing on responses to a survey of successful small enterprises in the three states. In addition to looking at the individual polices, however, we have also been able to identify within each of the states a particular policy-making process, one which has a certain similarity in Aguas Calientes, Jalisco and Chihuahua and which definitely is lacking in Michoacan. We propose to think not about how to replicate the specific policies but how to replicate and perhaps reinforce the processes through which those policies emerged. We discuss this approach in the last section of this chapter.

A. Framework for Industrial Promotion

Industrial promotion in Aguas Calientes, Jalisco and Chihuahua has been proactive, with state governments adopting multiple approaches to industrializing their territories. The more sophisticated scheme comes form Jalisco where the government has promoted both high tech and traditional industry. In high tech it has gone beyond the promotion of foreign direct investment to a more ambitious focus on plants, that are linked to the formation of a high skilled labor force, particularly in electronics and auto parts,. This approach have been complimented by an effort in traditional industries to foster clusters of small firms in order to obtain economies of scale, especially in design and marketing. Of particular note is the state government's plan to induce cooperation across industry boarders in jewelry, furniture and clothing through the creation of a single design center. The ambition is through the design center to generate a single Jalisco "look" which would be reflected in the products of all three industries and give the state a differential advantage in the national and international market place comparable to that of Milan or Paris.\

Chihuahua's industrial promotion policy has a narrower focus but is in some ways a better example of how decentralized development policy can emerge. It central thrust is to establish dialogues among producers that will lead to a common vision for the long-term development of the regional economy. These dialogues enhance business promotion in the central part of the state and create a second front in the development process along side the maquiladora approach which predominates on the border of the state in the city of Juarez. As a result of these dialogues, development in the state has come from the "bottom up", growing out of the producers themselves, rather than imposed from the top by governmental institutions. The experiences is an example of how promotion can work at a decentralized level, with little support from the Federal government, and bears closer examination.

Chihuahua: 'cowboys capitalism' promoted through intensive private-public dialogue

The surprise in Chihuahua is the way in which the cowboy culture of this dessert state generated an industrialization process. In the 1950's, the regional economy was completely dominated by agro business, while in the north a series of border towns earned a living offering small scale services, tourism, and prostitution to north Americans. The maquila sector which subsequently came to dominate the state economy grew out of a border dispute between Mexico and the United States over a piece of land called Chemical. The maquila program was a part of the Kennedy Administration *Allianza para el Progreso*: it sought to use the disputed land to develop a light manufacturing enclave, taking advantage of Mexico's low wages to process U.S. inputs in bond for reexport. The program evolved slowly in the 1960's and 1970's, particularly in contrast to similar programs in East Asian counties. The Mexican border development was more isolated and labor regulations did not afford the kind of flexibility found in the Far East. The early maquilas had virtually no impact on the rest of the State.

The impetus which converted the maquila program into an engine of state development came from a small group of manufacturing entrepreneurs in the central zone of Chihuahua. Prompted by social unrest in the late 1960's and 1970's which resulted in a number of significant land occupations, these entrepreneurs began discussions among themselves seeking a strategy to speed job creation. The discussions were formalized with the creation of *Desarrollo Ecnomico del Estado de Chihuahua, A. C.* In the 1970's, this group hired a consulting firm to develop a strategy for generating 25,000 new jobs a year, double the existing pace of job creation. The consultant proposed three basic alternatives: 1) the promotion of export industry, 2) tourism in the Chihuahua mountains, and 3) maquila development along the border. Difficulties with the first two options led to the selection of the maquila strategy.. With ten million pesos in State and Federal government support, Dessarrollo Economico launched a program of intensive promotion of the region among large companies in the U.S. combined with a system of industrial parks in both Chihuahua City and Juarez. The initial impetus for development in the center of the State was the decision of Ford motor company to locate a plant there. Ford in turn attracted supporting auto parts plants over the years. Other important international firms locating in Chihuahua were Honeywell, Kelsey Hayes and Yasaki. By 1999, the number of maquilas in the state had grown to 337, 25% of which are located in the center of the state in Chihuahua City. A distinguishing feature of development there is the high value added and relatively large number of employees per establishment relative to Juarez (and Tijuana) on the border.

In late, 1980's, concerned that the maquila development pattern was fragile, Dessarrollo Economico launched a new strategic planning exercise, *Chihuahua Siglo XXI.* Out of this exercise grew a strategy of promoting regional clusters of interconnected and mutually re-enforcing enterprises. The strategy has focused on three clusters: a maquila cluster in Juarez, and agro-business cluster in three municipios in the internal region of the state, and a cluster which combines maquilas and local entrepreneurs in Chihuahua City.

Table 2.3 Maquila Development in Chihuahua Compared with Tijuana

	Chihuahua		Juárez		Tijuana	
	Value added by establishment	Employment by Establishment	Value added by establishment	Employment by Establishment	Value added by establishment	Employment by Establishment
1990	0	500	0	487	0	130
1991	0	597	0	481	0	127
1992	0	515	0	477	0	124
1993	2035	564	1530	557	445	151
1994	1567	431	2195	642	655	184
1995	2717	520	3323	645	1092	192
1996	4106	506	4566	640	1428	209
1997	4407	504	5235	679	1588	215
1998	6984	551	8093	833	2110	208
1999	5968	575	7707	847	2083	210

Value added by establishment on thousand pesos

Sources: Estimated from INEGI database on Maquila de Exportación

One of the main features of the Chihuahua experience is that private sector promotion led to a restructuring of State government institutions and the creation of new supplementary programs . Programa de Apoyo a la Microempresa - that with Federal institutions – CIMO and Crece, created a network of supporting services for business development. One of the most interesting experiences of the collaboration between the private and public sector has been the creation of a suppliers development center, Centro de Desarrollo de Proveedores, which is a joint venture of private and public institutions, supported by the United Nations Development Program. Indirectly, the program was supported by the already existing educational network that had been built in the last twenty years in the State, namely Universidad Autónoma de Chihuahua, Universidad Autónoma de Cuidad Juárez, Instituto Tecnlógico de Estudios de Monterrey, Campus Chihuahua as well as the private sector training center in Juarez under the name "Centro para el Desarrollo Empresarial" (CEDE).

- ***Jalisco Experience: replacing traditional schemes***

Promotion policy in Jalisco emerged through a dialogue very similar to that in Chihuahua, but in this case less deliberation than by default. The government of Jalisco faced sever budgetary constraints in the period 1995-2001, and as a result has been forced to work through the existing business community, one of whose most active members was appointed the Minister of Economic Promotion (Secretaria de Promocion Economica (SEPROE). The minister has thus striven to develop a consensus within the business community about industrial promotion and, around that consensus, to work with existing business organizations and agencies. The main thrusts of policy growing out of this consensus has been the development of supplier networks for transnational firms and clustering and other interfirm projects within the traditional sections, both of which are discussed below.

The one new program of industrial promotion created by the state government itself is JALTRADE. This program is designed to address the specific program in Mexico: the absence of traders comparable to those in East Asia, who function to link business to foreign markets by grouping small firms and fostering their attendance at oversees workshops and conventions where they have first hand contact with the specific products which are being demanded abroad. Jaltrade was created as a mixed institution with both the public and private sectors. Its budget is based on a matching formula 50% of which is provided by the government and that 50% is matched by the private sector. Up to 1998 the program focused on shoe exports of SMEs. It was possible to get 30 firms into the program which were helped in the processes of developing their trademark, quality standards, and export niches in the U.S. Subsequently, it has been extended to include apparel, furniture and tequila firms. Jaltrade is also moving beyond its initial focus to develop an information system within the State Government to promote the exports of SMEs.

B. Supplier Development

Supplier development in Jalisco has been linked to foreign investment. Large international electronics corporations investment's boomed (at the lead were IBM and Hewlett Packard). IBM's production sharing facility in El Salto, located on the outskirts of Guadalajara, illustrates how U.S. companies use contractors and suppliers to perform specialized production functions that until recently were in- house operations. IBM manufactures three categories of products in El Salto: computers (desktop models and portable computers), subassemblies for hard disk drives, and software. To meet its production needs IBM has constructed in-house spaces for nearly all of its suppliers and contractors, from air conditioning installers to assembly line workers. This facility is IBM's largest in Mexico and exported 850,000 computers to markets in the Western Hemisphere. IBM's El Salto plant reportedly uses some of the most advanced production and design technology in Latin America; its 150 engineers design for use in IBM's worldwide operations. While approximately 7,000 people report for work each day at the El Salto computer facility, only 612 are permanent IBM employees. Contractors to IBM employ the rest of the workers. Suppliers with facilities adjacent to the IBM plant employ an additional 12,000 workers to fill all other intermediate assembly or manufacturing jobs. Other major computer firms located nearby, such as Dell Computer, frequently use the same suppliers and contractors (including those that provide employment services, such as hiring, training and supervising assembly workers). [2]

Development of suppliers have been growing since 1995, with twenty five just since then. This year, Taiwan Universal Scientific Industrial Co. (USI) began producing 2,900 computer motherboards daily for IBM in a new plant employing 270 people. These boards were previously shipped in from Taiwan. Parts of the computers used to be manufactured in Singapore, Taiwan, and Malaysia. Now, IBM's Guadalajara plant produces and ships them by air each day to a plant in San Jose, California, where hard drives are assembled for IBM's laptops, desktops, and servers worldwide. NAFTA helped persuade IBM to shift some operations from Asia to IBM Mexico, which in five years has boosted exports from $350 million to $2 billion.[3]

Table 2. 4 IBM Post NAFTA Vendor Development in Mexico

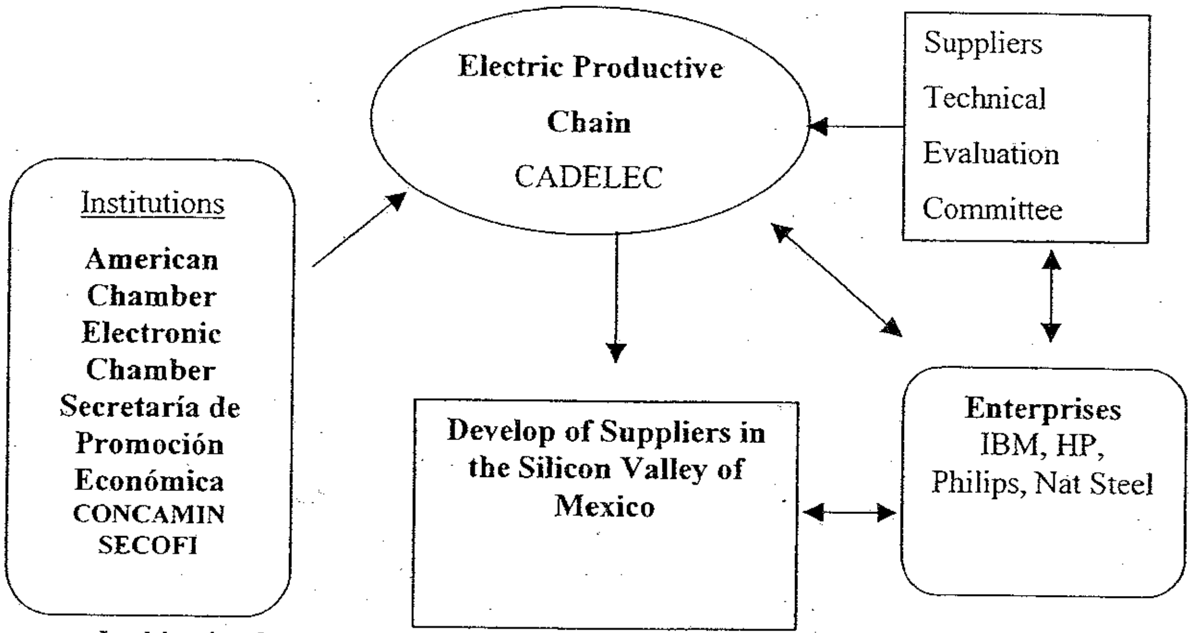
	1994	1995	1996	1997	1998	1999
Production	UREBLOCK ADATSA SONOPRES INTERELEC LITOCOLOR		INLAND LINCE NATSTEEL KEYTRONICS PHILIPS ALPS	YAMAVER ADFLEX DOVATRON SMARTFLEX COMPU-3	BDA-ADFLEX TER-SOFTER USI SPM NABS	METAL STAMPING BOX ASSEMBLY SOFTWARE DEVELOPMENT PLASTIC MOLD INJECTION FLEX CABLE
Non Production			EUREST OMNITRACK	SODEXHO HOLLAND USCO PRAXAIR SPECIALIZED	COMMANDER ESENSA EXTENDED LOGISTIC SERVICES ADVANDCED SERVICES (GAS) CONSTRUCTION CLEAN ROOM PRODUCTS	EXPENSE TOOLS REUSABLE PACK ADVANCED PERS. TRANSP. CLEAN ROOM LAUNDRY ESD PRODUCTS
Vendor in House				UREBLOCK	ADETEX APRO SERVIALTEC CASPEM SIEM SOLATEQ TECMAN SMARTFLEX	Extended services Extended services Extended services Extended services Extended services Extended services Extended services Extended services

RELOCATED. Current IBM supplier relocated in the area to serve IBM Guadalajara.
JOINT VENTURE. Current IBM suppliers established a joint venture in Mexico
DEVELOPED IBM Guadalajara developed suppliers
NEW COMERS New suppliers with firm plans to come into the area
EXTENDED SERVICES. Developed suppliers extended into new services.
Source: IBM Mexico.

[2] USITC Publication 3146 December 1998. Pag 2-13 to 2-14.
[3] Business Week December 21, 1998. Mexico After five years of free trade.

Hewlett Packard production facilities in Guadalajara assemble computers and produce printers. Here, HP has established its Mexican International Procurement Operation (MIPO) that allows Mexican producers to become international suppliers through the HP network. HP operations have attracted many foreign suppliers into Mexico who serve their PCA, cables, power supplies, repair / ref, PCBs, and publications needs. The high quality of production has allowed the HP Mexican Plants to become world-class operations, competing with HP Japanese plants, some of which have been moved to Mexico. Some of the HP suppliers are also selling to IBM. This makes it more attractive for foreign investors to move into the area because they can now enjoy economies of scale. This observation pushed the Electronics Camara of Guadalajara to promote a Supplier Development Center for the Electronics Industry under the name Cadelec (Cadena Productiva de la Electrónica). State government, with the help of United Nations Development Program, supported it, arguing that Guadalajara can become the Mexican Silicon Valley.

Cadelec has just begun operations in 1998, and at this stage has established an import substitution strategy of 280 million dollars in the electronics sector applying reverse engineering methodology. Financing comes from a fund constituted by the State government, leader companies in the electronic sector (IBM, Philips, Nat Steel), Fundación para la Innovación Tecnológica de las MyPes (FUNTEC) that is affiliated to the National Confederation of Industry Associations (Concamin) and the United Nations Development Program (UNDP). In it's first steps, it contributed to the production of "circuitos impresos" in joint operation of SCI, Novatex, Avex, Nat Steel, Solecton, and Cumex – and there exists now an assembling committee that looks after potential suppliers at the local and international levels.



Is this simply an extension of the maquila operation or is this a new production model or somewhere between? Only a few businesses are registered as maquilas, (79 of the13,736 manufacturing establishments, employing only 28,689 of the 311,488 in the manufacturing sector labor force. Existing manufacturing operations of TNCs in the Guadalajara area were not linked at all to the local supplier base but rather, imported from abroad. It was decided that under the new production scheme of just-in-time and competitiveness based on low cost operations, they needed to develop a suppliers network. The first step in this direction is a low value added operation that is bringing in outside suppliers that could respond immediately to the needs of transnational corporations. The big question is: will this model evolve and become more complex, developing a supplier network into the economy, or will this be a one time operation and foreign suppliers will keep importing from the rest of the world. A commodity chain will develop only if there are the required incentives which could develop a process of production complementarities.

C. *Reviving Traditional Industries: Clusters and Industrial Districts*

Jalisco has made the competitiveness enhancement of traditional industry a priority of public policy. Importantly, it pursued it with horisontal industrial policies which facilitate transfer of knowledge rather than distort relative prices. The state's development program, described in "Plan Estatal de Desarrollo 1995-2001". identifies fourteen targeted sectors, over half of which are traditional: agro industries, electronics, communication and informatics, leather, shoes, auto parts, metal mechanics and auto assembly, jewelry, wood, furniture, and textiles and apparel. Jobs in the traditional sector are still important in the region's employment profile (see table) and the State's strategy is to upgrade their quality. The approach is threefold: clustering, supplier development, and empresas integradoras. Of these, clustering is by far the most innovative.

Table 2.5 Jalisco: Employment in the Manufacturing Sector 1996-1998

Concept	December 1996	December 1997	December 1998	Variation Dec. 98/Dec.96 Absolute	Relative
Total	**231,919**	**275,019**	**300,480**	**68,561**	29.6
Food	45,499	49.974	53.277	7,778	17.1
Beverages	13,300	14.330	15.870	2,570	19.3
Tobacco Industry	492	515	532	40	8.1
Textile	8,097	9.565	9.643	1,546	19.1
Apparels	14,531	18.500	20,989	6,458	44.4
Shoe and leather	19,199	20.885	22.239	3,040	15.8
Wood industry	2,198	2.998	3.236	1,038	47.2
Furniture	9,713	11,764	14,016	4,303	44.3
Paper	3,343	4,445	4,867	1,524	45.6
Editorial and printing	6,389	7,287	7,826	1,437	22.5
Total, traditional industries	**122,761**	**140,263**	**152,495**	**29,734**	**24.2**
Chemical industry	16,076	17,289	18,189	2,113	13.1
Petroleum	890	1,014	1,030	140	15.7
Rubber and plastics	20,305	23,248	25,351	5,046	24.9
Non metallic minerals	8,476	10,047	9,808	1,332	15.7
Basic metal industry	4,036	4,980	4,976	940	23.3
Mechanical products	25,731	29,071	31,464	5,733	22.3
Machinery products	6,680	7,472	8,147	1,467	22.0
Machinery assembling	14,631	25,611	29,182	14,551	99.5
Assembling and reconstruction	3,716	5,993	6,805	3,089	83.1
Other manufacturing	8,617	10,041	13,033	4,416	51.2

Source: SEI-JAL, Sistema Estatal de Información Jalisco

The approach is furthest advanced in the shoe industry. The Shoe Chamber in Jalisco (CICEJ) has 450 members, most small and medium sized businesses. The industry suffered a crisis in the early 1990's with the opening to trade when it was swamped by massive imports from China. In 1998, the chamber decided to explore the cluster option as a way of restoring competitiveness. A first group of 23 firms began working together in that year; a second groups, consisting of 16 firms, was planned at the time of our study. The government (Fojal and Jaltrade) has supported the program financially but the chamber has allocated some of its own resources to the program as well. ITESO (Instituto Technologico de Estudios Superiores de Occidente) has provided technical support.

The program basically works by building trust and openness among the participants and fostering a dialogue through which the members enhance their common knowledge. Each member of the cluster, however, specializes in a different type of shoe. This configuration averts direct competition and avoids confrontations among the members, but it inhibits certain type of common action (common purchasing and marketing for example) and limits cooperative product innovation.

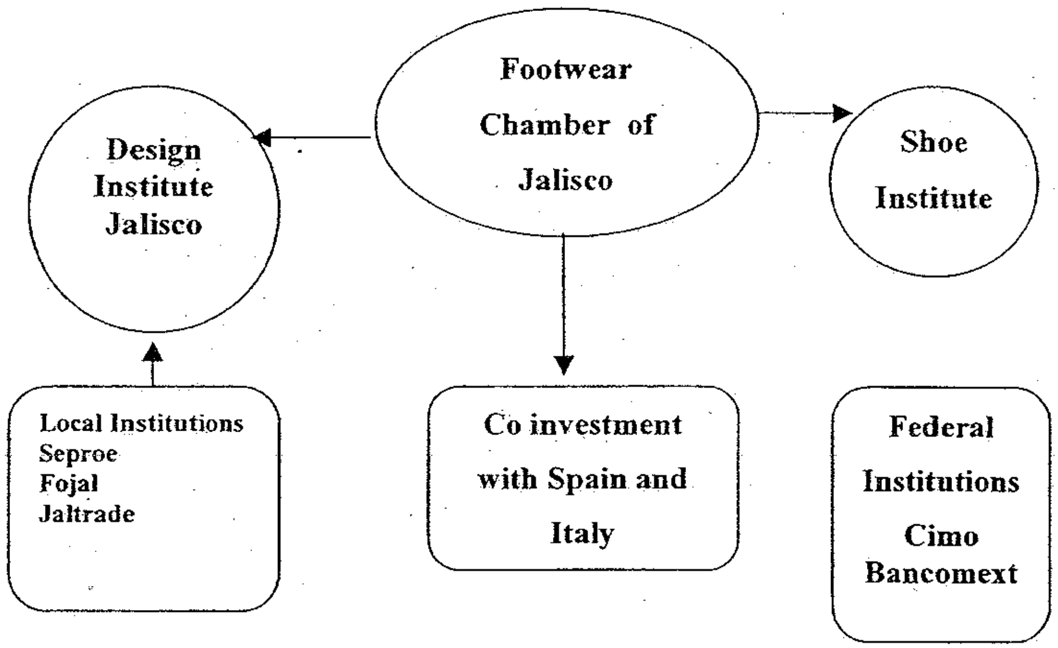
Dialogue among Jalisco shoe producers has been extended through the Chamber to their counterparts in Guanajuato, which has the largest agglomeration of Shoe producers in the country. Discussion between the two shoe producing communities has focused on the norm Conocer-GTO 2000, a benchmarking process which is designed to homogenize the producer network in order to facilitate efforts to reach ISO standards. There is, however, no agreement among Jalisco producers to adopt this process; the Chamber there is trying to modify the agreement before seeking the endorsement of its members.

Table 2. 6 The Footwear Industry in Guadalajara and Leon

Firm Size	Guadalajara	Leon
1-15	656	1,263
16-100	434	1,170
101-250	58	216
251 +	25	81
Total No. of firms	1,173	2,730
Total No. of workers	25,000	70,000

Source: CANAICAL 1994.

The dialogue within the Shoe industry is also extending outward within Jalisco itself to other traditional sectors. As noted earlier, one of basic development strategies in the State is the creation of a design center in Guadalajara that will help the shoe, jewelry, and apparel industry to become more competitive by moving up market. In Shoes, this means competing directly with Italy and Spain which till now have dominated design in that industry. The shoe industry learned through its experience with Chinese imports, that Mexico could not compete on the basis of cost with nations having a large labor surplus.



2.5 The Policy-Making Process: Discursive Problem Solving

As noted, an alternative way to think about the success of Jalisco and Chihuahua, and the stagnation of Michoacan, is not in terms of the specific policies they have pursued but instead **in terms of the processes through which those policies were formulated.**

Viewed from this second point of view – as a process – the chief characteristic of both states is the way in which development has grown out of extensive discussion and debate within civil society. There is no standard term to describe the nature of that discussion. We attempt to capture its character in terms of five points. First, the nature of the discussion is best captured by the term: "discursive problem solving". We use that term in contrast to what might be called "technical problem solving". Second, the discussions are extensive. Third, they replicate in their character the kinds of discussions through which policy is formulated within the multinational companies which the states are trying to attract through their industrial promotion policies and to whom they are trying to sell in their supplier development policies. Fourth, the type of discussion is replicated again in the policies designed to develop and upgrade clusters of firms in traditional industries. Finally, we look at the role of government and of politics in this process.

A. *Discursive Problem Solving vs. Technical Problem Solving*

We use the term "discursive" to distinguish this approach from what might be termed "technical" problem solving as understood in industrial planning or models of government policy making. Technical problem solving is also the basic approach that underlies engineering or the kind of rational decision-making prescribed in management science or attributed to the actors in rational choice models of social behavior. In technical problem solving, the decision-maker makes a sharp distinction between means, ends, and a set of causal models or technical relationships that link them together. All of these are supposed to be clearly defined and sharply delineated. The decision-maker then solves the problem by optimizing the degree to which the ends can be achieved given the available means and the constraints imposed upon their deployment by the technical relationships.

The approach to development policy and programming which emerged in Jalisco and Chihuahua is much more fluid. At any given time, the discussion may be focused on a particular problem, but the definition of the problem shifts continually as it is being examined. The nature of the available resources is constantly being reinterpreted as well in the light of the shifting conception of the problem itself, and what is viewed as a problem from one perspective can actually become a resource when viewed from another.

This result –which is completely paradoxical in technical problem solving– is nicely illustrated by the story of how the city of Chihuahua succeeded in attracting the Ford assembly plant. That plant is perceived as the key to the success of the city's industrial promotion efforts. The policy of industrial promotion in Chihuahua grew out of a discussion among a key group of business leaders about the disintegration of the social fabric of the state, the growing social unrest, and the wave of land occupations that were occurring in the city. They focused on economic stagnation and poverty as the underlying problem and on economic development as a solution. The idea of attracting foreign companies through active industrial promotion emerged through discussions with a U.S. based consultant and was modeled on the development strategy of the Caribbean island of Puerto Rico. The group lobbied the Federal government and obtained from President Echeverría a special ruling extending the maquila program to the interior of the country, and then began a long, drawn out campaign in the U.S. to find a major company prepared to locate in Chihuahua. It was finally successful in attracting the first Ford Assembly Plant in Mexico, and because other foreign companies then followed Ford, the Ford Assembly Plant turned out to be crucial to the whole development process in the interior of the state. But ironically, the land occupations, which the development strategy was designed to eliminate, turned out to be the key factor in attracting Ford to the state. When it came to selecting the specific site for the plant, the Ford officials examined several locations in Chihuahua. The site they finally selected – the ultimate decision to locate in Mexico was not independent of the final site selection – was one that bordered one of the barrios which grew up in the land seized by the peasants. Ford was attracted to that particular site by the manner in which the people living in the barrio had invested in their own housing, which the Ford officials interpreted as a signal of the industriousness of the labor force and their commitment to staying in the region. In this sense, the land occupations, which initially was the problem that the business community set out to solve through industrial promotion, ultimately became the means for promoting the location of foreign industry.

B. Extensive Character of the Discussions

The approach to policy formulation is not only discursive but also "extensive" in the sense that it connects to and draws into itself discussions outside the State, among management and development consultants but also within multinational companies and between those companies and their suppliers. It also extends to the state government but, although the government could conceivably animate such discussions or encourage them, government is not the key player.

The kind of discursive problem solving involved in the formulation of development strategy in Jalisco and Chihuahua connects readily to discussions outside because a process of discursive, as opposed to technical, problem solving, also generates the policies of the external actors, which are critical for development within Mexico. The conventional rational decision-making models would lead us to believe that multinational companies have a clear idea of what they are looking for in an industrial location; that there are a series of indices in terms of which a state's attractiveness is measured. It implies that state policy should be targeted toward improving its position in these various indices. But multinationals do not seem to operate from such a list. They are themselves engaged in an internal debate about what the determinants of a good location are and how they should be measured. Variables such as political risk or the likely evolution of key markets are hard to specify and difficult to measure. Locations in the automobile assembly industry were oriented toward the domestic market but the plants turned out to be producing primarily for export. In Mexico, labor is cheap but management is expensive and turnover is high. An interior location could cut down turnover, but it might also make it hard to attract labor, especially skilled technicians and management. All of this will be further complicated by subsequent supplier decisions; if suppliers are located nearby this will reduce the uncertainties of transportation costs but it may increase labor market pressures.

Supply decisions of multinational corporations are the outgrowth of a similar process. Indeed, there is a major debate within the manufacturing sector –one which is replicated within virtually every large multinational company– about supply strategy. The debate basically pits a strategy of central sourcing to one of on-time delivery.

A further point to make about these discussions is that there is not a clear line between the discussions through which policy and programs are formulated and the programs themselves. Thus, as we saw earlier, key program in the revival of the traditional industries of Jalisco are *agrupamientos*, small groups of enterprises in the same industry that replicate among themselves a process of discursive problem solving, which is very much like the process through which the state initially formulated its development policies. Each group consists of twenty to thirty enterprises whose owners meet regularly over a period of several months in problem solving sessions focused on the business problems of the individual members. Each member comes to the group with a specific business problem; the problems are presented one by one in turn to the group; the group then discusses the problem, visits each other's plants, and tries to help its members formulate a solution. Sometimes outside consultants are hired to help in the process, but the focus is on the interchange of experience among the members of the group. In the process, group members often change the definition of the problem and almost invariably the concept of what would constitute a solution.

This process is one that actually leads to more efficient and effective management practices. But it also builds up a network of relationships among the firms involved and overcomes the kind of extreme autonomy and isolation from which Mexican traditional industry has suffered. This in turn leads to cooperative ventures within the industry. The most ambitious of these ventures in Jalisco is the plan to create a design center for traditional industries that can establish over time a regional style comparable to that of the emphasis style of Milan. The kinds of discussion which occurs within the agrupomientos in Jalisco is very similar to that which Chihuahua has sought to foster among the groups of agricultural producers which it calls clusters. The nature of these discussions is essentially the same as that which occurs in the formulation of the policy of industrial promotion or the policies of supplier development.

These discussions, however, contrast sharply with the efforts to upgrade the furniture industry in Michoacan discussed above. The contrast provides another illustration of the difference between <u>discursive</u> problem solving and <u>technical</u> problem solving. The agrupamientos utilized a format which left the definition of the problem open. Each individual member defined the problem of his own business and that definition was then discussed by the other members and often modified or discarded in favor of a completely different alternative. The integradora in Michoacan, in contrast, hired a consultant to tell them what their problem was. The consultant quickly focused on quality and reliability — understandably, as these are the chief concerns of foreign customers. He then recommended the series of specific solutions suggested earlier, involving using the inferior pieces of wood for the hidden, interior parts of the furniture and a redesign of the plant lay-out to improve the flow of materials. The entrepreneurs readily adopted his suggestions, but it was clear from our own discussions with them that they had essentially learned them by rote. They had not acquired an understanding of what quality and dependability really meant, which would enable them to develop other improvements on their own. In our terms, they had not learned to participate in the international discourse about quality and reliability or to speak the language in which that discourse is conducted. The structure of the consulting process would never have led them to trace the problems they experienced in the marketplace to the more fundamental issue of the way the relationship between the household and the business was defined. Nor would it enable them to think about the institutional infrastructure in the form of schools or local banking which would have to be created to support a change in that relationship which drew a hard line between the realm of the household and the realm of business. Indeed, in contrast to Jalisco and Chihuahua, where the discussions within the agrupamientos and clusters grew out of and were linked to a larger discourse about regional economic development, there is no way in which a focus on schools or local banking, had it actually emerged from the discourse about quality and reliability, would have fed into the process of policy formulation at the level at which these aspects of the infrastructure could be addressed.

C. *Government*

In both Jalisco and Chihuahua, the kinds of policies that grew out of the discursive process we have been discussing have come to be closely associated with government policy and particularly with the PAN, which assumed power in those states at critical moments in the development process. But the discursive process long predates the government policies, which appear to grow out of it or the advent of the PAN government. In Chihuahua, as we have already noted, the process was initiated by a group of business leaders in the capital city in the late 1960's and early 1970's. In Jalisco, it grew out of discussions in various Cameras, and among them and the Mexican managers of the larger, multinational electronics firms. The PAN to some extent absorbed a discussion already underway and, once in power, seems to have adopted many of the policies generated by that discussion, but it did not invent the policies nor was it responsible for initiating the process. Rather, entrepreneurs and managers who were already involved in the discussions as private citizens assumed official positions in the new Pan governments and carried the discussions with them when they came into power. In Chihuahua at least, the new Pan government also sponsored a second generation of discussions, which produced Siglo XXI and shifted the focus from the promotion of multinational firms to secondary development based on the promotion of clusters of local firms and of a base of local suppliers. But what remains distinctive about the policy-making process, even under Siglo XXI, is the way it is rooted in civil society. The close association with the PAN has actually placed the whole process in jeopardy, when the Party lost the gubernatorial election in 1998.

Box 2.4 Local Economic Policies and Local Politics

The relationship between economic policy and partisan politics in Mexico is in fact quite complex, and important elements of that complexity have been obscured by the way it is reported in the popular press. Typically, the PAN is presented as a conservative business party in a way which implies that it is a strong adherent to neo-liberal, market, oriented policies. PAN does tend, in point of fact, to be a party of business. But this has meant primarily a commitment to efficient government, i.e., to the business-like conduct of government affairs. It has not meant an opposition to government programs or a commitment to the market in a neo-liberal sense. Indeed, the PAN is a Catholic party that recognizes economic, as indeed all human activity, as embedded in a larger community and judges its contribution not in terms of individual success but in terms of community welfare. And PAN sees its policies and programs in terms of their contribution to that larger goal. What it opposes is the use of government in a clientelistic fashion to reward party adherents. Because Pan is both a catholic and a business party, its members tend to have been educated —to the extent that education is important in the way they think about economic policy— in business schools or schools of regional planning, where the concepts of supply chains and industrial districts are taught as opposed to orthodox departments of economics.

The PRI by contrast is, as we have already noted, split into two wings. The technocratic wing which had dominated Federal policy, is educated in orthodox economics and neo-liberal in inspiration and essentially favors the withdrawal of government from the economy altogether. The base of the party, by contrast, continues to think of government in political terms and to administer its programs in an unembarrassed clientelistic fashion. The PRI is changing less in philosophical terms than in response to an electorate that is increasingly concerned with the quality of public services and with development of the broad economy and less and less closely tied to the corporatist groups around which the Party had historically been organized and in terms of which its clientelistic policies were pursued. Absent that corporatist organization, it is not always easy to map particular government economic policies onto the Party's supporters.

Although the PAN-ist states have been most closely associated with the process of discursive problem solving that we have been discussing here, the PRI is in many ways suited to the conduct of such broad-based discussion within civil society. As an organization, the PAN is a narrow, membership-based party; adherents are admitted only after they have been approved by the membership committee and have gone through a program of training and indoctrination. The PRI, in contrast, is a broad based mass party, which has faced its electoral challenge by seeking to draw new groups into itself. It has often sought to do so by offering, and delivering, particular material rewards, but it could equally as well seek to do so by broadening the party program and the kind of discursive problem solving discussed here would be a natural way to do this. In the abstract, one might think that the PRI is also better suited to administer the programs in a discursive way. The PAN's commitment to business efficiency could easily lead to a narrow, problem solving approach to program administration. But, in point of fact, as we have seen in Jalisco and Chihuahua, the PAN has not administered its programs in a narrow, technocratic way. And to the extent that the PRI cannot seem to escape its clientelistic tradition in administration – and leaving aside the neo-liberal wing of the party in Mexico City, one could almost say, for discursive problem solving, the PRI is best suited to policy formulation, the PAN to its administration. But obviously the interplay between the two parties on this score is extremely complex. Discursive problem solving cannot be equated to either party or, indeed, as we indicated initially to government policies and programs in general.

D. *Initiating the Cluster Process*

Without government as the focal point, it is much harder to understand how the discursive process is initiated or how it can be replicated in areas where it does not already exist. The material we gathered in the case studies does not provide an answer to this question. In Chihuahua, as we have noted, it is possible to trace the process to a small group of businessmen in Chihuahua City concerned about the disintegration of the social order (and, one might add, the threat which it posed to their own property holdings and economic welfare). A secondary motivation appears to have been the competition with Ciudad Juarez on the border for power and influence within the state, although, over time, Juarez has been drawn into the discussions. The rapid pace of development that ensued, but also the strong sense that the original group had actually succeeded in initiating the development process, provided the momentum for the discursive process to continue.

In Jalisco, the roots seem to go deeper: they are connected to the historic sense of civic consciousness and the strong communitarian religious tradition in the state. The traditional industries –shoes, garments, jewelry, and furniture– have also historically had a strong institutional infrastructure, albeit one which was greatly strained by the opening to trade. Jalisco is also one of the few places in Mexico where the power and influence of the national Cameras were contested on the local level by the creation of independent organizations and, as a result, there is a continuous tradition of debates within local industry. In our interviews in the state, policy initiatives and ideas were very frequently traced to earlier historical precedents. In this sense, the withdrawal of Mexico City from active involvement in the micro-economy did not create the vacuum it did in other parts of the country.

Finally, in both Jalisco and in Chihuahua, an important factor is the debates, which occurred within the foreign business community and among the multinational producers. As mentioned earlier, the process of decision-making in which the branch plants locating in Mexico are involved within their own companies is very similar to the kind of discursive problem solving which has emerged locally. Once this local process starts moving it is easy to draw the managers of these branch plants into it.

In understanding the emergence of discursive problem solving in Jalisco and Chihuahua, the contrasting case of Michoacan is helpful. But it is helpful primarily in dissipating various ideas, which emerged in our interviews and seem to circulate widely, about the nature of Mexican society and of the Mexicans as a people. The one series of ideas, which has some credibility in Michoacan, is the nature of the political process. The state has an extremely partisan and conflictual political history. In recent years, municipalities have been split between different parties, many have changed hands with some frequency through intense, partisan elections, and the state government has at times aggravated these conflicts by supporting particular municipal governments and favoring them with resources. The problem we would emphasize however is not the role of government: the discourse, which is key to the process as it occurred in Jalisco and Chihuahua is one within civil society. The political conflicts cannot have facilitated the civil discourse, but a more neutral government of the kind now emerging in Michoacan will not by itself create the discourse when it is absent.

Where the conflictual nature of state politics has undoubtedly been more of a problem is in deterring direct foreign investment. Foreign companies do not like to locate in areas where they risk being drawn into social conflicts. As a result, Michoacan does not have the kind of economic base which has supported development in the other states and which is clearly responsible for the impression there of success. Without foreign investment, moreover, it is obviously more difficult—or though perhaps not impossible—to develop a program of supplier development. On the other hand, Michoacan does have significant assets of natural resources and historic monuments that could support independent economic development in the form of agro-business and a tourist/hospitality industry. It is very far from realizing this potential.

A very promising example of the emerging cluster approach is the rehabilitation of historic Morelia, the capital of the state, and its emergence as a site for tourism, conventions, and foreign language instruction. The process through which this occurred began when a series of small civic clubs formed to save and restore particular historic buildings in the city's downtown. It grew as these initially independent clubs established relationships with each other. A larger project to reorganize commerce in the city, freeing up the congestion in the center, and the orientation toward the hospitality industry apparently grew out of the discussion among the clubs and was eventually adopted by the municipal government.

The development of Morelia is thus in many ways a small example of the kind of discursive problem solving we observed in the economic development of Jalisco and Chihuahua. It suggests that the problem even in that state is not one of how to create a process from scratch but how to expand it. The question in Michoacan is perhaps not all that different from the problem in the other states of how to sustain the process of discursive problem solving already under way over time. We turn to address these issues in the next chapter.

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Chapter 3: Elements of the New Decentralized System

3.1. Understanding the Client: Characteristics of Successful SMEs in Mexico

In order to place the state strategies in the context of the Mexican companies whose fate they were trying to influence, we conducted a survey of most successful small enterprises. The survey focused on identifying the relative roles of 1) entreprenuership, 2) market institutions, private networks and interfirm linkages, and 3) public programs. It focused exclusively on successful firms, drawing a sample of entrepreneurs from firms identified by local informants as particularly successful small businesses. The sample was drawn from all three of the states -- Jalisco, Chihuahua and Michoacan, whose adjustment strategies we studied. A total of 121 interviews with these entrepreneurs were conducted in 1999.

Our respondents clearly reflected a new managerial profile in Mexico. Only one fifth of the sample had inherited their business. Many had followed a trajectory of university education with subsequent work experience and training in transnational firms before founding their own businesses. Of the total, 73% had some higher education and 36% reported their major motivation was to develop their own ideas (against 33% who were motivated primarily by income). As a group they were extremely self-confident: 90% reported that they felt confident managing competitive work groups, 85% enjoyed the leadership role, 88% felt capable of convincing others to change, 89% felt capable of handling unforeseen events.

In developing economies most SME's do not have the capacity to deter the entrance of competitors into their markets. Their competitive strategy is based on cheap labor or other cost cutting strategies. These however have proven to be self defeating. Seventy-four percent (74%)of the respondents in our sample reported that they believed that cost reduction is not the best way to be competitive. They are focused instead on innovation as a competitive strategy.

The innovations they pursue, however, are not high tech process innovations but rather innovations in tradition processes and products. Improvement in competitive position, they report, comes first from improvements in standards of quality; 73% of firms believing that high quality is the best means to be competitive. But only 42% were actually involved in quality improvements. Many of the firms in the survey said that they have realized process or product innovations, but only a few of them have undertaken a systemic approach to innovation such as registering product innovations. Eighty nine percent report it is clear that most innovations come from improvement in daily processes and that these are undertaken without government support.

International free trade agreements pose new opportunities only to those firms who are able to mobilize the internal resources necessary to gain entry into international markets or to defend their traditional local markets. Survey firms argue that the factors that pushed them to export were mainly the high quality of their products (50%), increasing external demand (19%), and competitive prices (19%).

In developing export capacities the government has played an important role but chiefly through Bancomext. Two thirds of the exporting firms in our sample report receiving Bancomext support. Other government agencies were not reported to be very supportive in developing export capacities.

One of the main obstacles to effective entrepreneurship in Mexico is that cooperation among firms is not common. Firms operate in relative isolation from each other. One of the goals of the survey was to identify the potential role of supply chain linkages in overcoming this isolation. Here regional differences turned out to be important. Supply chains are relatively weak in Chihuahua, stronger in the central states of Jalisco and Michoacan. The linkages along the chains in Michoacan were generally based on raw materials; whereas manufacturing linkages were more common in Jalisco.

Our survey results indicated that subcontracting increased in Mexico in the 1990's as a result of the reorganization and reorientation of both local and foreign firms. But the relationships which developed tended to be what might be called *soft subcontracting.* They did not involve a commitment to the long term or to supplier development. One important impetus to inter-firm cooperation suggested by the survey was the grouping of small firms to meet an order from a customer that was too large for any one of them to accept on its own. Substantial idle capacity among small firms facilitated this development. A second impetus for subcontracting relationship was financial; this was largely a response to the collapse of the financial system in the mid-1990's and the virtual disappearance of traditional sources of working capital.

When firms were questioned about what type of support they receive in their subcontracting relations, 50% reported that financial assistance was the main support, 30% reported technical assistance, and 20%reported technology transfer. In other words, subcontracting overcomes temporary supply constraints but does nothing to foster the dynamic development of subcontractor's competitive strength. This type of relationship did increase income, however, in 79% of the cases.

Business associations have lost ground in Mexico since the enactment of the new law governing the business chambers or *Camaras*. It is no longer compulsory to register, and most firms do not see the benefit of this type of association. Among our survey respondents only 30% were registered in any type of industrial association; the main affiliation was to Canacintra. Business associations do little to breakdown the traditional isolation of Mexican firms. Only 42% of those who were members reported profited from that fact. The services which they received were mostly promotion (31.7%); and training, (16.3%).

One of the main limitations on the interaction among private and public institutions in Mexico is the limited flow of information between them. Forty-four percent (44%) of the firms reported that they did not know of government programs that could help them to improve their business environment. Firms that were aware of these programs got the information from government offices (51%), rather than from Business Associations (19%). When a business was getting some sort of support it came mainly from the state government (41%), or from the Federal government (37%); just 12% received support from local governments. The most important support at the local level have been in training and upgrading mechanisms. CIMO is the most popular program and is well accepted among entrepreneurs. Forty-seven percent of interviewed firms rated the Federal programs as good, but not the state or local programs. There is little knowledge of the more complex assistance systems as Crece or Compite.

Entrepreneurs rated financial support as being inadequate; there is no trust in the agencies delivering these services. This is easy to understand if one considers the collapse of financial intermediaries that occurred during this period. The financing of surveyed enterprises comes mainly from their own sources: 74% from savings and 6% from family sources. Capital funding sources in surveyed firms show that only 8.2% of total financing is from banks, 2.1% from government programs, 1.1% from the informal sector, and 8.2% from other sources. Government funding has thus been marginal for this group of businesses. Rating for traditional public services were quite different from those for business services: local government was rated relatively highly, state and Federal government poorly.

Overall, the survey shows that adaptation is taking place at least among the successful small firms upon which we focused and that the entrepreneur's innovative roles have played a key factor in this process. The adaptation is especially marked among those for whom entrepreneurship is the culmination of a career trajectory which includes a university education and work experience in a transnational corporation. Entrepreneurs with this profile have adjusted competitive practices not only through process upgrading, but also through the redesigning and reshaping their product line to enter the North American Market. However, even among these firms, the level of sophistication is very uneven. The same firm might use very sophisticated technologies, for example, while possessing only the most rudimentary cost accounting system. Archaic training and human resource development practices coexist with the most advanced marketing systems.

The uneven development of managerial practices reported within a single firm may in part reflect the limits of the questionnaire on which the survey was based. However, the pattern of the differences across industrial sectors suggests that the variation in the quality of managerial practice within the firm reflects the fact that practices have been upgraded in response to specific shocks and particular pressures, which vary systematically from one sector to another. As already noted, practices tend also to reflect the career profile of the entrepreneur. Another important determinant is the firms position along the supply chain: Risk aversion and lack of planning are, for example, characteristic of firms in supply chains that are less integrated. Organization size and age, on the other hand, do not appear to be powerful in distinguish among the managerial practices adopted by different firms.

Similar conclusions are reached by comprehensive surveys of successful firms in semi-industrialized countries. For example B. Levy (1994) studying successful exporters in Colombia shows that private networks, not public programs and the main sources of managerial and technical knowledge for firms. This implies the emphasis on interventions which would enhance the individual effort and private-to-private collaboration.

3.2. Best-Practice Principles of PSD Promotion

As the survey results indicated, the central policy challenge for industrial promotion is to encourage transition from inward-looking firms, narrow search routines and information-poor markets to learning-oriented firms and mature, information-rich market. The best-practice incentive framework to encourage this transition can be summarized in the following metaphor: the best intervention follow 'light touch', 'jazz orchestra' 'embedded autonomy interventions'. All interventions have performance-based organizations with strong project execution capabilities behind them. What follows explains these metaphors.

A. 'Light touch' approach: complementing market and individual effort

The economic and institutional perspectives suggest drawing a sharp distinction between initiatives that require only a light touch from the government (for example, network thickening initiatives) and initiatives that require high-intensity government support (such as coordinating investment or picking winners). High-intensity initiatives should be approached cautiously, or not at all, unless countries have unusually strong institutional capability. By contrast, light-touch initiatives are those that are inexpensive and accelerate existing demand-driven changes rather than restrictive and command-oriented. An inventory of light-touch instruments is summarized in Table below.

First movers in doing new things (breaking at non-traditional export markets, for instance) are critical: since small firms learn most productively from each other, the success of a first mover provides powerful examples to follow and thus has a positive spill-over effect. Because of the spill-over effect, some public subsidy to first-movers is justifiable. How to deliver such a subsidy? The relevant knowledge (about export markets and on the upgrading of the firm) is highly specific and can be provided only by independent service providers. A firm-level management governance scheme proved to be a promising solution. This scheme includes creation of a public fund managed by a private management service provider to offset (usually on a 50/50 basis) certain fixed start-up costs of breaking into export markets. Funds are provided on a "first come, first

Table 3.1 Inventory of 'Light touch' Interventions				
Instruments	Target by population of firms	Objective	Assumptions and major risks	Lessons from successful examples in industrializing/post-socialist economies
Private sector-driven credit guarantee fund	Micro and small enterprises	Provide partial credit guarantee to incentivate lending of financial intermediaries to SMEs	Existence of local entrepreneurs with god projects;	Spain, sociedades de garantías reciprocas
Business incubator; Private-public seed funds	High-value added start-ups and spin-offs	Provision of capital and managerial knowledge to new firms	Existence of local entrepreneurs with god projects;	Israel, India, Brazil (Lalcaca, 1997) Public sector participation is useful to an extent that it leverages private sector resources. Public sector accelerates and facilitates the response of the private sector, but not creates
Matching grant schemes	Any firm starting to export	Acceleration of entry into export activities	Additionality as a critical issue (whether the matching grant induces new activities or just subsidizes activities that would have occurred anyway)	India, Argentina
Information centers (to take advantage of Internet)	Firms with high demand for business knowledge	Promotion of access to business information (on prices and business opportunities) and facilitation of local content creation	Demand-driven nature of the center (otherwise becomes a room with computers) and its sustainability once initial public subsidies are terminated	Chile: CepriNet Peru
Network thickening initiatives	All firms	Formation of enterprise support infrastructure through formulation and implementation of collective initiatives	Capture of the fund by the established interests	South Africa

served" basis – once eligibility criteria are met, every firm receives support, and the fund is temporary (3-4 years being a typical duration). The latter is important: once exporting ceased to be innovative activity, thereby not leaving any learning spill-overs, there is no reason for the public fund to exist. The private management service provider administering the fund operates under a time-bound contract with performance benchmarks and acts as *global network information broker* (by providing relevant information to firms), markets the scheme to the firms, provides up-front, free support in preparing firm's programs and acts as an impartial administrator.

There are two contrasting approaches to the provision of seed funds in support of localized experimentation: *quality enhancement and quality control.* Institution-light approach relies on quality enhancement rather than effort-intensive quality control. Funds are disbursed on a 'first come, first serve basis' under transparent eligibility criteria. A firm-level management scheme is an example. Institution-intensive approach relies on *contests* -- institutional structures in which firms and other agents compete for valued economic prizes or rents offered by the government, such as access to credit. Contests involve *rewards* (preferential access to credit and foreign exchange), *rules* (export requirement), and *referees* (fair rules of the games). Although in East Asia contest-based competition complemented market-based competition in encouraging aggressive learning through exporting, institutional capability to select winners, enforcement and monitoring rules are extremely high. As the current financial difficulties in Korea (a paragon of contest-based competition) demonstrate, laxity in allocation of contest-based credit may prove a time-bomb that would seriously impair the financial system.

B. 'Jazz orchestra' approach: orchestrating collective learning

Under this approach, the government (or central authority in general) *orchestrates decentralized learning by monitoring and assuring information-sharing between local experiments.* Central authority does not direct--it facilitates information sharing, encouraging improvisation and experimentation, as in a jazz orchestra

The jazz orchestra principle (information exchange through continuos networked interaction) is the underlying principle of the decentralized learning in many areas of SME performance.

Box 3.1 Government as a Facilitator: SMEs Adopt IS0-14000 Standards Through Innovative Supplier Development Program

In 1996, eleven large companies (domestic and multinational) in Guadalajara signed a two-year, voluntary agreement with Mexico's *Secretaria de Medio Ambiente, Recursos Naturales y Pesca* to mentor small suppliers in implementing environmental management systems (EMSs). Each company invited two to three small suppliers to participate in the pilot. The large companies and the World Bank provided the SMEs funding for EMS training and implementation support. A team of consultants – from two local universities and a foreign environmental management-consulting firm – delivered the services. The aim was to implement the ISO 14001 EMS model originally designed for large firms for the SMEs and evaluate the applicability of the model as well as the sustainability and replication of the pilot partnership.

As of late 1998, the pilot was encouraging, with virtually all participating SMEs making major advances in the implementation of ISO 14001, the reduction of pollutants, and their ability to use general management systems. Moreover, the national government has used this experience to develop the substance and implementation methods for new environmental protection legislation.

The success seems to have depended on four principal factors. First, most SMEs indicated that the invitation from the mentor company, rather than simply from the government or university, was a vital source of motivation and cooperation. While all participating firms had some sense of "ownership" in the project, the presence of a large company "champion" provided important assurance that their dedication was not misplaced. Second, the use of the consultant network provided resources otherwise unavailable to SMEs and even many large firms. The network in effect provided a rapid response system to local and firm conditions through a diverse group of experts who drew on one another's wide range of skills and knowledge. Third, although they attended the pilot's sessions mainly as observers, representatives of local and national environmental authorities focused managers' attention on the project, and prompted many of them to learn about the benefits and drawbacks of different standards and enforcement actions. Fourth, beyond the training in technical issues, the use of benchmarks and an iterative, collaborative review progress both demonstrated new forms of cooperation to participants at all levels and improved the information basis on which they could build the next round of efforts.

C. 'Embedded authority' approach: governing through power-and information-sharing

The role of the central government in a network of semi-autonomous agents is rather subtle, if not paradoxical; a government can better govern if it gives up the attempt to (unilaterally) rule. A government gains in authority as it gives up some power to networks and associations of organizations, and then redefines its leadership using the consensus or vision that emerges from the interacting organizations. Since that consensus is arrived at by the semi-autonomous activities of the decentralized agents (within rules, guidelines, and frameworks provided by the central authority), those agents have an ownership and a "buy-in" to those policies, an ownership that would normally be absent in a centralized command system. In this manner, the government creates a type of embedded authority so that its resulting policies will be effectively implemented (in contrast to token compliance and eventual sabotage of centrally imposed policies). Perhaps the best-known examples are the deliberation councils of post-war Japan although similar policy networks have developed in a number of the other high-performing Asian economies (Singapore, Korea, Malaysia, and Thailand). The deliberation councils illustrate the "paradox" that the government can better govern if it does not try to rule arbitrarily. As a result of the consultation and deliberation within the council, the government's implementation of council-determined policies have a power and an effectiveness that centrally-imposed policies would not have. For instance, Japan is a strong state in the sense of having this "embedded power" in a relational network society, not in the sense of having the arbitrary power of a hierarchical central government.

D. 'Champion' principle: importance of industrial promotion organization with performance-oriented incentives and strong project execution capabilities

Performance of a industrial promotion agency, just like of any other organization, is a matter of incentives and capabilities. The agency is expected to perform three basic functions. First, it facilitates *demand* for restructuring and learning by ensuring that managers and government officials share a mutual understanding for both the need for restructuring and involving external consultants. Second, the agency assures efficiency of the restructuring: it trains enterprise managers how to utilize external consultants. Foreign consultants are often of limited effectiveness to SMEs due to the differences in their language, social and professional backgrounds. . As a result, local consultants are needed to facilitate interactions. Trained locals tend to understand what makes an owner of a small firm tick. Finally, the third role of the Agency is a familiar role of market-driven consultancy – provision of managerial expertise. Box 3.3 examples of good industrial promotion agencies.

Box 3.2 Performance-Oriented Promotion Organizations
Example 1: ProChile

The first example is the Export Promotion Fund, PROCHILE, a government foundation supporting export projects proposed by groups of firms in the same sector. The program was one of several efforts to expand exports launched by the Pinochet government after the country's economic collapse in 1981-82. Individual firms were ineligible for the program, under which the government financed 50% of each eligible project. In addition to financial subsidies, PROCHILE supported approved projects, and of course the firms clustered around them, with specialized services such as the collection information on foreign standards and market trends, and the organization of study visits to the facilities of foreign competitors. Current and potential exporters therefore had strong incentives to form sector-specific committees which in turn defined individual projects that might qualify for the financial and other subsidies.
The projects typically aimed at some combination of improved quality to meet international standards and development of new products for world markets. The first sectoral committees grouped producers of processed fruits and vegetables, salmon and other processed seafood, fresh fruit, furniture, textiles, wine, and paper products. By 1988 there were some 65 committees consisting of six to 14 enterprises each, and including all told over 700 firms.

Example 2: Foundation Chile: Incubating New Enterprises

In the 70s, following bold macroeconomic reforms, Chile found itself with liberal and stable macroeconomic climate yet with sluggish export growth. For a country with impressive mineral and natural resource wealth, agro-industry appeared to be a promising route to follow, yet institutional infrastructure (leasing companies, demand detection, market information etc.) was lacking. Agro-processing was dominated by huge enterprises created by Allende, now privatized but still monopolistic. Bottom-up facilitation of new agri-processing value chains became the task of Foundation Chile – hybrid organization combining the features of project development facility (to identify promising opportunities at the world market), technology incubator (to adapt promising agro-industrial technologies and establish firms to pilot the new technology) and seed venture fund (to finance the firms and realize an upside gains once the firm is sold to private investors). Foundation Chile is widely credited for the ensuing surge of Chilean exports in reared salmon, tomato paste, table grapes and other export products.

Social returns of Foundation Chile are much higher than private returns (upside gains upon selling the successful firms) because of demonstration effect of new SMEs (bringing new technology up to scale in a number of firms) and technology transfer effect. Hold no illusion: Foundation Chile is a rather untransparent institution and not surprisingly, it made many mistakes by investing into technologies that later proved unsuccessful. It is untransparent both in its origin (it is an arranged marriage between ITT corporation which put 50% of an initial endowment in exchange to retribution of its assets nationalized by Allende and the government of Chile) and its operational transparency (a hybrid of project development facility, technology incubator and venture capital fund). But these caveats make Foundation Chile all the more interesting: it is a second-best response to a highly imperfect institutional environment.

Experience shows that the above principles can be summarized in the so-called Triple-C approach to SME policy.

Triple C Approach to Local Industrial Promotion

World experience shows that to be effective, interventions need to be:

- **Customer Oriented** - efforts must be driven by the needs and demands of the customer. This forces firms to face up to underlying problems of competitiveness. The most successful interventions are those which have helped firms to learn about their customers, and then introduce the changes and innovations needed to meet market demands.
- **Collective**- outside assistance is most effective when it is directed at groups of enterprises, rather than individual firms. This means working with business associations, producer groups, and other industry alliances. Where they do not exist, support can be linked to the formation of such groups. This has two advantages --- it is more cost effective than assisting enterprises individually, and it helps to develop constructive relationships between firms, which can improve their efficiency and increase the potential for learning from each other.
- **Cumulative** - one-off improvements are not enough; if firms are to remain competitive they need to be able to change and develop in response to new market conditions and new opportunities. The objective should be to help generate this capacity within groups of firms so that in the longer term public support is no longer needed.

Added together, these elements represent a fresh approach to SME promotion, which has been dubbed the 'Triple C Approach'.

3.3. Practical Challenge: Entry Points to Unleash Private Dynamism

While state action and market-oriented PSD have often been perceived as in conflict, it is increasingly apparent that states and markets are complements. States provide the foundation of institutions on which markets and private activity are built. And private, profit-seeking firms create the wealth – and hence the fiscal resources – that governments need to perform the social functions entrusted to them.

These complementarities are mutually reinforcing: stronger performance on one side creates pressures for performance to improve on the other side. As private entrepreneurs seeking to compete in the international marketplace come up against weakness in the domestic business environment (i.e., a judiciary incapable of enforcing contracts, regulatory and infrastructural and many other obstacles), they are likely to lobby for reform. Correspondingly, as the legal and regulatory environment becomes stronger, the character of the private sector is to evolve by "crowding in" firms seeking to profit by creating wealth, and "crowding out" firms that thrive on opportunistic, rent-seeking activities. This interplay between states and markets helps foster a **virtuous spiral – a cumulative, mutually reinforcing process of private sector development.**

In fostering industrial development, the central challenge for the Mexican government and for the World Bank group is to identify and implement interventions that **can initiate and sustain this virtuous spiral**. To unlock the virtuous spiral of reforms, it may be useful to put special emphasis on tangible (concrete, visible) initiatives, not as a substitute for continuing policy and institutional reform, but as an "entry point" from which systemic constraints can be identified more specifically, and from which less tangible reforms would follow as corollaries.

This approach carries a variety of practical benefits. First, the concreteness of the goal creates a strong incentive for government to embrace the PSD agenda, and makes it easier for governments to defend the complementary reform package in terms understandable to the stakeholders. Second, concrete goals translate much more readily into benchmarks to measure progress in implementation and to signal when to continue to play and when to withdraw. Third, it enables a focus on specifics of the business environment. With greater attention to the details of doing business, it is possible to get at the root of some of the dysfunctionality and systemic problems which may not be readily seen at the macro level. Fourth, by linking investment projects and policy and institutional reform programs, the approach provides a focal point for WBG staff to work together despite widely differing areas of specialization.

One can visualize this approach as **bootstrapping** – the process of incremental bottom-up change in which a favorable balance of risks and returns encourages firsts steps from many diverse entry points, and each move unlocks the virtuous spiral of institutional reforms and private sector development.

Entry point initiatives need to have two components. First, provision of public good of better business environment and image-building for foreign *investors (first-order of business for the government)*. Second, specific initiatives of horizontal industrial policy allowing to accelerate observed positive changes in firm's behavior (matching grant schemes, business incubators, private-public seed funds, facilitation of private-to-private collaboration through business associations, information centers). Much has been done in Mexico in the area of deregulation and improvement of the business environment. Deregulation efforts will now need to shift to the State level (See Attachment I for detailed deregulation agenda). Horizontal industrial policy interventions will be discussed in the remainder of the report.

3.4. Entry Points for the Less Developed Mexican States: Creating Favorable Business Environment for 'First Movers'

The staple of development economics of the 50's and 60's – the problem of low-level equilibrium trap (*vicious circle of mutually reinforcing depressed demand and rudimentary supply response*) has emerged as a serious problem in some States of South-East of Mexico. Thirty years ago the vicious circle of poverty was perceived as inability of market signals to engineer 'minimal critical effort' or 'big push' to wake up and catch up. A bittersweet irony of the modern version of the depressed regional economies in Mexico is that it occurs amidst and partly as a consequence of massive economic liberalization that fosters national economic growth and prosperity. Yet the otherwise successful liberalization may impose such a political and economic costs in some regions that result in suppression and distortion of certain regional markets altogether. In such regions one has a paradoxical impression that Hayek and Polanyi are *both* winning the argument!

Provided factor market work reasonably well, the low-level equilibrium trap should be a figment of our imagination. According to the principle of comparative advantage, any country would always have comparative advantage in something. Yet to take advantage of comparative advantage, one needs to develop business linkages with markets, usually export markets to sell the output. Institutions and capabilities must be developed to transform comparative advantage into competitive advantage. The less developed Mexican States lack such capabilities and institutions, Institutional failure is offset by well-functioning functioning labor market. Massive migration both from South East of Mexico to the US reached such a scale that migrant' remittances appear to provide both sufficient social insurance for those who stay in the country and promises (via collective investments by migrants living in the USA) an eventual 'minimal critica effort' to revitalize the depressed areas in question.

There are three distinct approaches to unlock private dynamism in the conditions o low-level trap. One is *hierarchical solution* of integrated development programs. Th record of integrated development programs is close to dismal and they are **not** suitable t the modern conditions of simultaneous political and economic liberalization.

The second, simultaneous political and economic liberalization, coupled wit decentralization produces collaboration between economic entrepreneurs and civi entrepreneurs. Sooner or later such a collaboration would result in a so-called dis-entrenchment -- emergence of political and economic forces willing to add private and public value rather than engage in habitual rent seeking. In its emphasis on idiosyncratic inducement mechanisms and heroic figures of civic and business entrepreneurs, this approach takes root in Schumpeter and Hirschman and does not lends itself easily to operational replicability. To get a gist of this approach, see Box 3.3 for a discussion of transformation of Ceara State in the North-Eastern Brazil.

The third approach, the one we are proposing in this report, focuses both on regional entry points –private-public programs and national support infrastructure which allows entry points and innovative initiative like the one in Ceara to be monitored, replicated from one State to another and scaled up.

A discussion of an example-in-the making may help to clarify the argument. The example starts from an observation even stagnant regional economies characterized by pervasive market and government failure like Chiapas state in the south Mexico have tiny pockets of vitality and dynamism driven by private sector investments. Pulsar group (a large dynamic company with a base in Monterrey) has been modestly successful by engaging community land holders in a program of eucalypti planting and exporting. In effect, Pulsar engineered a private integrated local development program by providing services ranging from land titling to housing, community infrastructure, education and health services provision. As such, transfer of an integrated development program approach from public domain to private sector is not particularly new. Many multinationals in sub-Saharan Africa and public companies in the former Soviet Union rely on this approach, for lack of a better solution. A typical outcome is a mineral-

Box 3.3 Unleashing Private Dynamism the Brazilian Province of Ceará

In 1987, the newly elected reformist governor of Ceará, Tasso Jereissati, initiated a set of reforms that would radically improve this poor Brazilian province's fiscal health and economic growth by 1993. A key set of reforms included innovative, decentralized programs in preventive health, public procurement from informal-sector producers, and a large emergency employment-creating public works program. In addition to decentralizing operations and integrating more private sector participants into the programs, the provincial government utilized two key methods to improve the governance of the programs.

First, the provincial government used its political authority and financial power to break the traditional hold over program management by clientelistic stakeholders while empowering other, less powerful local groups. Second, the provincial government defined the rules of program management to promote participatory monitoring by both service providers and users.

These two methods were at the core of a demand-driven procurement program that fostered sustainable backward linkages between large customers (in this case government procurement agencies) and vibrant networks of SMEs. The most celebrated achievement was the transformation of the backward district of Sao Jao dò Aruaru (SJA). The impact on the town was startling. When the program began there were only four sawmills in the town, with just 12 employees. Five years later there were 42 sawmills, with about 350 workers, and a further 1,000 people directly or indirectly employed in the woodworking industry. Importantly, the customer base has been diversified over time, so that now over 70% of output goes to the private sector.

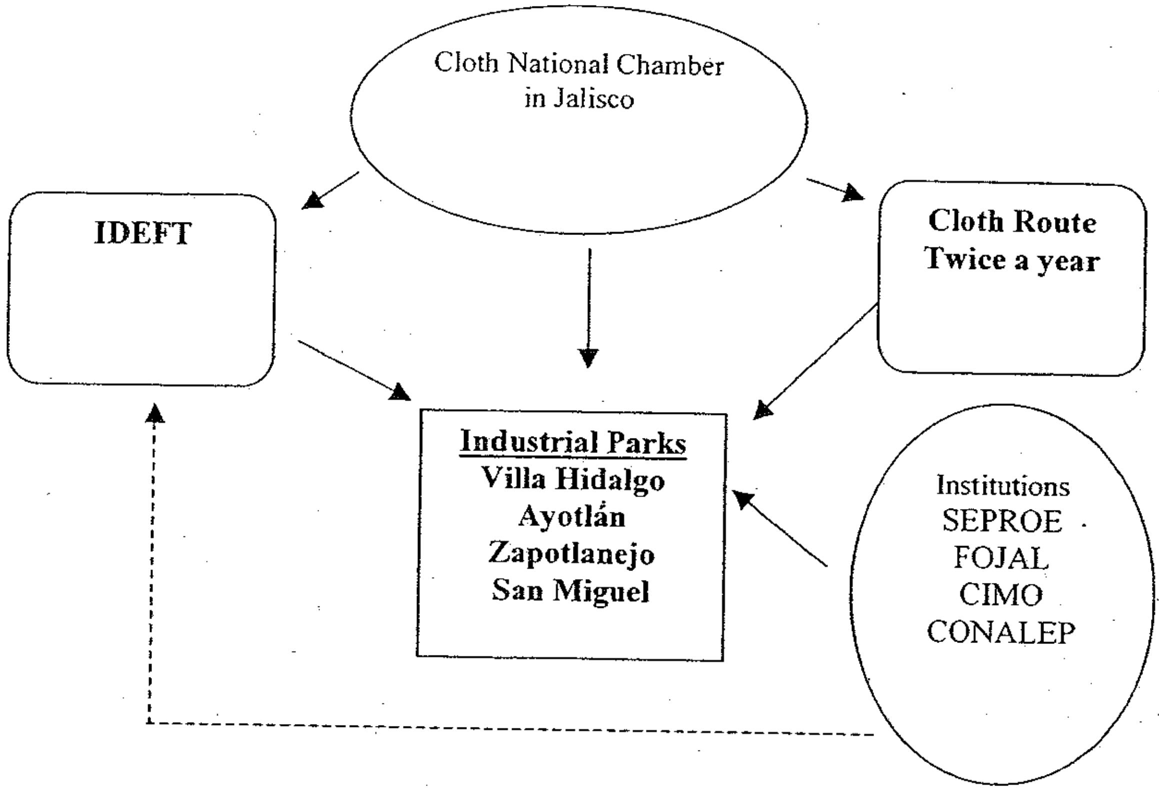
The Ceará government first broke the hold of large out-of-province suppliers and of stakeholders, like large banks, in supply-driven SME programs by having the public procurement departments, the Departments of Agriculture and Education, seek SME suppliers with the aid of two traditional SME support agencies. At the same time, rather than using subsidized SME credit schemes and long-term procurement contracts, the procurement departments had the support agencies offer a 50% advance on each contract with a supplier for a particular order, with full payment based on customer satisfaction (criteria of quality, delivery time, and price). In so doing, the government not only provided cheap initial capital to firms that they would otherwise not receive but also offered them a reliable customer base if the firms could meet procurement criteria. Success with a relatively simple order brought larger, more complicated orders. Moreover, the support agencies contracted not with individual SMEs but rather sought out existing SME associations and aided the formation of associations of potential suppliers located in one place. Over time, these associations became an organized political group that could pressure the government to expand the program and facilitate the development of new banks and training resources as well as counter the power of traditional large suppliers interested in re-cooping their patronage.

The next crucial success factor was the government's development of a collective monitoring system that fused information sharing, risk sharing and learning. First, the government **separated customers from suppliers, using performance-based contracts**. The procurement departments contracted with the SME support agencies to supply goods and services and supply SMEs with technical assistance. The support agencies received a 5% commission on each contract, the revenue from which became an increasingly source of finance for the agencies. The **agencies, in turn, contracted with SME associations, which became responsible for finding** the relevant member to manufacture the product and meeting the terms of the contract. Each subordinate had more detailed knowledge than the superior of adequate suppliers and operations and thus simplified the monitoring tasks. Each superior had the right to select, reward, and penalize the subordinate and all had revenue sharing incentives.

This draws on Judith Tendler, 1997, *Good Government in the Tropics*. Baltimore: Johns Hopkins University Press.

resource-based enclave amidst a stagnant economy. The multinational company is co-opted into the cartel of entrenched interest. In contrast to this typical outcome, the Pulsar case appears to be an entry point to the broader process of reform by bootstrapping. More specifically, Pulsar has entered into negotiation with public service providers in an attempt to forge alliances with the environmental agency, education and health ministry with an end to jointly reform relevant service provision. To the extent that a such a dialogue is meaningful, i.e. would result in the entry of new actors into established services provision arrangements and reform of existing programs, one can expect that a tiny private sector enclave would produce reform linkages in the whole region.

Such processes are already occurring in Mexico. For instance, one of the most successful clustering associations has been in the labor intensive apparel sector in Jalisco, which is the third largest industry employing 20,989 workers in the region. But much of the state's production originates in isolated clusters in rural villages. The isolation has its roots in the history of the industry which dates from the early 19th century when women were not allowed to work. The Catholic Church, in this extremely religious area, however, fostered a tradition of embroidery in the home for the local church. The skills developed in this way then became the nucleus for the apparel industry which grew up in the small, isolated clusters around the local churches. Over time, virtually every little town of Jalisco became a small apparel cluster, but as their market was small, economies of scale were not possible. The Apparel Business Association—with it's more than 1200 members—decided to promote linkages among these isolated clusters by developing what has been called "Ruta del Vestido". This is a bi-annual fair in four of the main counties of Jalisco: Ayotlan, Villa Hidalgo, San Miguel, and Zapotlanejo, whose purpose is to promote the apparel of each county. Because of their isolation, each area is so diversified that no one member is threatened by the another's product.



This has led to an increase of production for each small cluster, bringing economies of scale and a renovation of the apparel industry of the region. A second step that is being considered is the construction of industrial parks in Villa Hidalgo (for 60 to 70 enterprises) and in Zapotlanejo –where more than 300 manufacturing firms and 1200 commercial establishments are located. The long range plan is that each of the counties where there are apparel clusters will have an industrial park. To upgrade manufacturers, a training center will be developed in San Miguel – Instituto de Formacion para el Trabajo (IDEFT). The center will have machinery given by the producers, and firms will have to pay a recuperation fee for each trainee. The Apparel Business Association, the Secretaria de Promocion Economica (Seproe), and county governments of Cimo and Conalep supported this development. Training has been the main support, as well as the design of a program of apparel, "Hecho en Jalisco". The program has become so successful that a second stage is being developed which will include the counties of Ocotlán, Tepatitlán, Arandas, Teocatiche, Yahualica, Cd. Guzmán y Xotepec.

3.5. Entry Points for the States of the Center-North: Promotion of Linkages from 'First Movers'

As noted in Chapter 1, Mexican private sector in the center-North has a **bifurcated structure** in which internationally competitive conglomerates coexist with largely domestically oriented and often non-competitive SMEs, with limited linkages between these two sectors. While there is a dynamic and growing export sector, it is increasingly assuming (i.e. more than before the mid-1980s) features of an enclave sector with limited domestic valued added. This results in insufficient employment creation, given the limited role of SMEs and low productivity growth. The central challenge of economic growth and poverty reduction strategy in these regions remains, extending the productivity benefits of economic liberalization to SMEs by encouraging greater export orientation in a larger share of firms, strengthening linkages between the export sector and the rest of the economy, and encouraging technology transfer between foreign and domestic firms.

Both Mexican (see discussion of Jalisco experience in Chapter 2.3) and international experience (Box 3.4) indicate that promotion of backward linkages and supplier development is a highly efficient way to address this challenge. There is a scope for a demonstration project in the Northern and central Mexican states that would aim at reducing initial risk and transaction costs of establishing collaborative relationships between large internationally competitive buying companies and their actual and potential suppliers. **The outcome of such a relationship is to upgrade quality, technology, marketing and design capabilities of suppliers, and better quality of inputs for the buyers.** For instance, a pilot application of methodology of supplier development prepared by NAFIN and UNDP, which involved five large Mexican buying firms and 24 SMEs as their strategic suppliers resulted, in the course of a year, in significant gains for small suppliers and large buying companies. The thrust of the methodology is coordinated private-sector driven provision of technical assistance (ranging from simple auto-diagnostics to ISO9000/ISO 14000 certification) and capacity building for small suppliers. The pilot group of SMEs recorded 46% increase in labor productivity, 26% reduction of inventories, 10% costs reduction; while large buying companies reduced payment period to small companies by 75% and increased productivity of the purchasing departments by 30%.

To achieve those gains, buyers and suppliers relied upon and adapted to their own needs the whole gamut of SME assistance programs. Hence a pilot supplier development initiative would provide a powerful impetus to redesign public enterprise support infrastructure.

The objective of the demonstration supplier development initiative we propose here is enhancement of competitiveness of SMEs by fostering financial, marketing and technical linkages between large internationally competitive firms and small-scale suppliers of their inputs. This objective would be achieved through: (i) the improvement of access of suppliers – small and medium-sized firms -- to sources of finance and technical assistance; (ii) promotion of better integration of SME support services provided on company, regional and national level; (iii) support of the Government promoted decentralization by strengthening State-level SME support institutions; (iv) design and implementation of monitoring and evaluation system to provide cost-benefit assessment for private, regional and national supplier development initiatives. As discussion of previous chapter shows, there were a number of supplier development initiatives in Jalisco, Chihuahia and other states of Mexico (see Ruiz, 1998, Abdel, 1998, Jica, 1998, FIAS, 1995). The proposed seeks to builds on their lessons and establish a permanent system of monitoring of promising supplier development projects.

The initiative seeks to fulfill its objective by establishing a coherent system of Supplier Development with clear rules of responsibility and accountability of private actors (buying companies, their suppliers and financial institutions), State governments and Federal agencies. The proposed system combines technical assistance and access to finance component at three levels – company level, regional/ cluster level and national level (See Fig. 3.1).

On a company level ('micro-level initiatives'), interested large buying companies are starting to form Institutes of Supplier Development (technical assistance vehicle) and/or Fideocomiso AAA (a company-level trust fund to finance suppliers). The proposed initiative would not finance the private institutes but would provide assistance to help redesign fine-tune existing company-level supplier development efforts

On a cluster/regional level, large buying companies in collaboration with Secretaries of Economic Development of State government would form small private-sector managed cluster Institutes for Supplier development (in autoparts and furniture sector, for instance) to serve collective needs of a cluster. State governments and buying companies will provide financing of the Institutes.

On a national level, public good of creation and dissemination of policy knowledge will be provided. The existing 'Grupo de Refleccion' of large buying companies to share their experience of supplier development (being convened jointly by UNDP and NAFIN) will be strengthened. Two technical working groups (finance and technical assistance) will be formed to coordinate development and testing of new products, and monitoring and evaluation of the outcome and impact. The Initiative would have an Internet-based monitoring and evaluation module facilitating documentation of private and social gains of supplier development efforts and sharing of experience. With accumulation of the documented experience of supplier development initiatives, the Private-Public Advisory council is to be formed consisting of top private and public leaders to provide strategic direction to supplier development efforts.

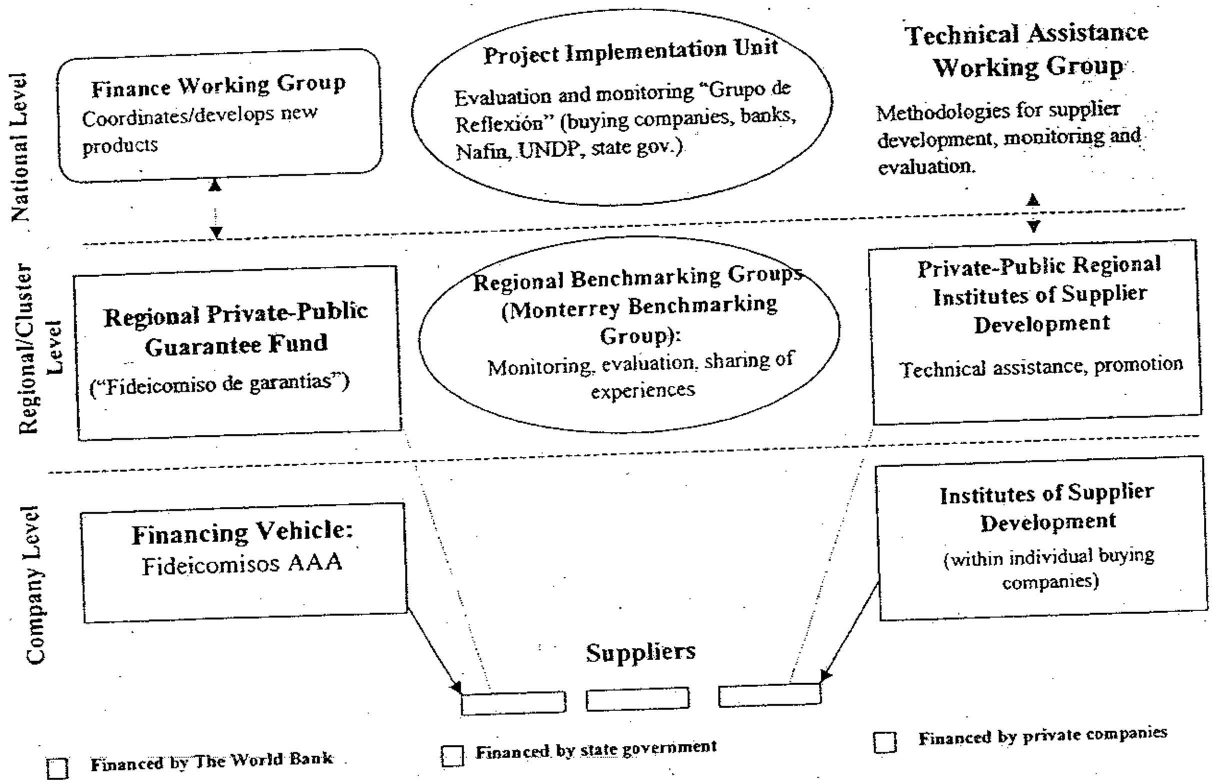
Box 3.4 Supply Chain Initiatives

Supply chain initiatives involve SME that are part, or could become a part of a supply chain, which in many cases is led by a larger company. The object of initiatives promoting vertical networks is to strengthen linkages between these companies. In recent years there has been a significant growth of interest in these networks, partly because of the extensive reorganization occurring in global supply chains. A rapid increase in outsourcing has occurred, changing interfirm divisions of labor and responsibility ('what is done where' – for example, which company, in which country, manufacturers the components of a vehicle, and which assembles them into a vehicle). New logistics systems aided by information technology are also a factor in the restructuring of global supply chains.

Supply chain initiatives can aim at linking up local SME firms to customers and international markets. They can also assist the growth and long-term sustainability of these firms by addressing the issue of their strategic position in the chain. For example, a company can be helped to move on from being just a 'labor only' supplier, or one that merely carries out simple assembly tasks, to being an own-product manufacturer, brand-owner and seller. An example of this was a scheme to develop the footwear supply chain of an international show company's branch plant in Bangkok: it involved actions to link the plant to new rural suppliers of labor, who initially carried out simple assembly activities and then helped them progress to higher levels of activity.

Promising examples of supply chain initiatives relevant for Mexico include:
TAIWAN: the Centre-Satelite System program, promoted and administered by the CSD Industrial Coordination Center, aims to strengthen supply chains composed of either larger manufacturers and their small suppliers, or large raw material suppliers and their small manufacturer customers. The object is to encourage big and small firms to form stable networks to upgrade quality, improve management, lower costs and streamline operations
MALAYSIA: The Vendor-Support Program
CHINA: Production Networks for Exports Program.
UNITED KINGDOM: regional development agencies such as the Welsh Development Agency, Scottish Enterprise and the Northern Development Company are all active in promoting supply chains

Figure 3.1. Mexico: Pilot Supplier Development Initiative



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Chapter 4: Decentralized Incentive Framework of Industrial Promotion

4.1 The Maze of Industrial Promotion Programs

Recall our introductory parable where benevolent government official was left with the Gordian knot of a bewildering maze of industrial promotion programs. Equipped with the knowledge of best practice of industrial promotion and the conceptual framework, our official decides to cut it with the sword of practicality: Instead of imagining problems and speculating about potential solutions, she makes a list of existing state programs and see whether they *already* add up to a workable solution for the failing firm and others like it.

Her first efforts at cataloguing programs are not encouraging. NAFTA exacerbated the productivity gap between small and large firms in Mexico, both in rural and urban areas. Realizing that small firms, employing more than half the labor force, urgently need to increase their technological and marketing capabilities, the Ministry of Trade and Industry came up with 28 programs to help them. If other agencies are taken into account, the number of programs reaches almost 200. Potential beneficiaries – employees of small firms are usually not even aware that the programs exist, let alone satisfied with their performance. Her heart sinking, our official realizes that many others have come before her, stumbling upon failing firms and successful ones. Skipping all her troubling questions, they made cursory lists of potential problems—and, created program upon program in response. But on closer look the situation is not so bleak.

First, some centrally administered programs are in fact flexible enough to help formulate and respond to the idiosyncratic needs of small firms, at least in the judgment of their beneficiaries. An example is the Labor Ministry's "Quality and Modernization" program, which covers up to 50 percent of costs of training and consulting services. Since "training" and "consulting" are very broadly defined to cover almost all aspects of re-organization, nearly every small firm can receive support for the re-organization projects it deems most urgent. Resolution of urgent problems brings new shortcomings to light. Precisely because the program is driven by demand, and demand is self-reinforcing in that one project often suggests others, its scope has widened from labor retraining to cover the whole range of services for detecting and addressing the firms' problems.

Second, regional governments, in particular in the States of Jalisco and Chihuahua in the entrepreneurial North of Mexico, catalyze innovative partnerships between regional government, the private sector and civil society. With continuous consultation and information sharing these partnerships help the actors create a shared vision of a promising future, the obstacles to it, and paths around them. In effect firms discover they have problems by looking at the innovative solutions of others, and how these differ from their own. In time, agreement on good practices in particular areas cumulates into a serviceably precise image of a competitive firm; and this image comes to guide the problem-solving activities of individual companies and the program as a whole. Although joint problem-solving partnerships such as Chihuahua Siglo 21 and Monterrey 400 are too new to allow for full evaluation, some benefits are already apparent. First, by decreasing information and search costs, they improve the investment climate. Second, by facilitating mutual commitment among diverse stakeholders (government, civil society, private sector) generate tangible projects: the discussion of Jalisco and Chihuahua in Chapter 2 provides examples. Third, in a country subject to a pronounced political cycle (major policies are linked to presidential administrations, which by unwritten law have a life of six years), they assure continuity of economic policies and so help stabilize the economic environment.

Just as promising firms exist side by side with less promising ones, practical cases of state intervention are comforting as well as consternating. To connect effectively to world markets many small- and medium-sized firms have to rebuild themselves extensively, piece-by-piece, in idiosyncratic sequences. This kind of reconstruction is possible only if the actors (firms, workers) who have the knowledge of what needs doing, but lack the resources to do it, can somehow team up with actors (government, commercial banks) who have resources, but lack the direction to deploy them effectively. To state the demands of the situation that way is to raise the suspicion, bordering on a certainty, that government—neither local nor nation—can by itself identify these chains of particular needs with sufficient precision to design programs which deliver them. Horseback empiricism—just counting the countless programs that already exist—bears this out. But national government *does* sometimes create framework programs and corresponding incentives that do allow firms in effect to co-design the services they need with the service providers. Regional governments *can* partner with firms and civil society to create what might be called program programs: visioning exercises or consultative groups which provide environments within which firms can shape the particular programs they need. When this happens the framework programs help create the institutional infrastructure through which, we saw, firms establish the discursive links that they need to compete.

So our intrepid official has another and decisive question: How can the government act deliberately to design programs that create these framework or meta programs? No sooner are these queries thought than our official is back in the saddle for some more horseback empiricism, looking for cases close at hand that suggest government can induce the matching of resources to knowledge that it cannot command directly. Two Chilean and examples, and a further one from Mexico, provide a hint how it can do that.

4.2 Looking For Trouble: How Government Can Help the Economic Actors Design the Programs they Need

From the best practice examples (see previous Chapter 3) our official begins to conclude that in important ways moving up a level—from specialized but innovative development programs to frameworks for creating them—is no change at all. The framers of program programs can no more assume that they know which ensemble and sequence of programs to design than project organizers can assume that they (or their clients) know the correct projects to undertake and how to order them. The job of the framer, like that of the project or program director, is rather to create incentives for actors to become dissatisfied with what they are doing, and to find ways to address this dissatisfaction that lead to the discovery of new ones. The job, in other words, is to get actors looking for trouble and keep them looking for it even as they overcome the troubles they find. At this very general level, she realizes, public frameworks and programs are doing just what competitive firms do as a matter of routine: using error detection and correction to discover and overcome their present limits without pretending that they have anything like full knowledge of their current situation, let alone a precise ideal towards which to strive. From this perspective a "national" framework would amount to launching a group of demand-driven state-level or sectoral programs simultaneously.

Being well- (often, she thinks, over-) educated, the official realizes too that after the fact—when frameworks and programs have been working for a while—they have been correcting market failures or providing strategic orientation that the economic actors could not correct or provide themselves. But she has learned it is a costly mistake to take these analytic conclusions as practical starting points for the provision of development assistance. The lesson of the many, many flawed programs encountered on the way to a few success stories is that when public and private actors start with the explicit intention of doing something so precise as listing and correcting market failures, or defining the most suitable strategy, they seldom manage to. ("Improving the supply chain" and "building clusters," she has found, are not so misleading as conceptual starting points. But the reason, she suspects, is not analytic superiority but something close to the reverse: these categories are so open-ended that they invite just the kind of searching discussion that frameworks aim at, while providing the reassurance of a vocabulary current in business schools and business.)

But on further reflection she realizes that starting a large framework initiative to develop new-style programs involves more than just doing whatever it is that the innovative programs do in a bigger way. There are, it seems, at least two closely related ways in which the move from programs to frameworks does entail changes. The first, apparently formal, and therefore arguable irrelevant difference concerns scope. Frameworks are by definition more comprehensive than programs. They typically cover more territory—provinces and regions, and whole industries, or complexes of them, if not the whole nation—and include more, and more complex, actors. Programs might either involve many actors at one or several locals, but few beyond or above them, or, alternatively, actors at the national and sub-national levels dedicated to a narrowly defined task. Frameworks on the contrary typically involve several jurisdictions of government (federal/state, state/local, or all three), public institutions (technical schools at a minimum) count several, perhaps many existing programs (for disbursing credit, or providing technical assistance) as participants along with firms and the work force as primary actors. Of course this distinction is much sharper for traditional, highly bureaucratized programs and frameworks (the kind our official started counting) than for the open-ended, innovative type whose tracks we are following here. The exemplary programs that our horseback empiricism uncovered succeed because, being open-ended and demand-driven they do not respect jurisdictional boundaries. So in operation they come to encompass a complex variety of actors, and therefore to resemble (little) frameworks.

But such niceties aside there is a difference in complexity and scope between programs and frameworks, and the difference contributes directly to a second and manifestly important difference between them as regards governance. Governance, in our real-world parable, is the rules and institutions that assure that public programs are not corrupt and, beyond that, serve the clients they are intended to serve. (In this case that would be firms and other economic agents who need help helping themselves as opposed to those who will do just fine unaided.) The difference with respect to governance is crudely this: Governance for innovative programs can be, and very often is, so informal that it is a bit of a euphemism to think of it as institutional at all. But governance in innovative frameworks, for better or worse, must be formalized, and in a way that draws attention to non-traditional features of the activities contemplated.

The informality of innovative programs is so much a piece of daily life in magical realism that it takes our official a moment to realize that it is not simply a general condition of life. After all, if the field is crowded with economic-development programs that work poorly either singly or taken together, it is not totally surprising that from time to time a few conscientious officials band together to try something better. Pooling some of the discretionary resources at their disposal, and perhaps augmenting these funds with monies available from some new and shiny program launched nationally or locally, they go about their business. They cooperate across boundaries that have long since lost meaning for them in their professional activities. Most of those who might be upset at their trespassing are part of their merry band, or too discouraged by failures to feel threatened by self-proclaimed innovators. When an innovative program does actually become successful enough to expand, and so threaten resources dedicated to traditional projects, it will have probably acquired its own enthusiastic and dedicated clientele of firms and officials, near and far, who rally to its defense against the attacks of yesterday. Thus, protected by invisibility, a conspiracy of silence, or enthusiasts disinclined to be critical (all key to the politics of magic realism), the successful innovative program can progress without establishing formal accountability.

But even an official as innocent of officialdom as our guide senses that framework programs can not escape detection in this way. The are unlikely to arise informally because the actions of top-level actors—ministers, the heads of large public agencies and the like—are too closely scrutinized by parliament, the courts and other oversight bodies to allow for the quiet concertation that makes innovative boundary crossing at less exposed positions. Formal creation of a framework on the other hand is likely to draw lots of attention. The mere announcement of a large initiative is likely to be interpreted by those left unsatisfied by existing programs as a chance to say what they need, and by those who administer those programs as a criticism of their activities so far. If current programs were encouraging economic development, surely there would be need to create bold new programs to do the same another way. Between the cheers and shouted advice of their potential friends and the quieter, but perhaps more influential jeers of their natural enemies the framework is going to be in the public eye. It must be accountable, and so it needs formal governance.

Recent Mexican experience how abruptly governance can become a central issue in economic development, and how fragile the even the best programs are in its absence. The CIMO program, referred to above is a case in point. So long as it was a small program attached to the Ministry of Labor and Social Security informal administration was acceptable. But as the program began to succeed, and become a model for others its informality was suddenly seen not as a pre-condition of flexibility, but rather as a receipt for chaos and failure. Indeed the "disorder" in CIMO made it easy for other ministries to claim that they would learn the lessons of the project and implement them "responsibility"—in conformity, that is, with bureaucratic practices said to assure fairness and efficiency. In a related way the program in Chihuahua, we saw, came to grief when the political color of state government changed, and the new leaders could use the weak institutionalization of the framework to attack it as a misguided hodgepodge.

Box 4.1 Irish Regional Partnerships

Ireland is embarked on an innovative experiment to reduce the incidence and mitigate the effects of unemployment while further encouraging the development of an open, competitive economy. At the core of that experiment are 38 Area-Based Partnerships (initially 12) in urban and rural communities created by the Irish Government and the Structural Fund of the European Union (EU), beginning in 1991. The task and opportunity of these partnerships is to reconsider the problems of un- and under-employment within their home jurisdictions and devise effective responses to them that the central government alone could not discover, but to which it may refer in reforming its own administrative structures and, above all, in improving the connection between these and local communities.

Legally the partnerships are independent corporations under Irish company law. Their boards group representatives of local community interests, including the unemployed, representatives of the national social partner organizations of labor and business, and local or regional representatives of the national social welfare, training, or economic-development administrations. Through this structure, the partnerships often have de facto authority over a significant share of the local activities and expenditures of core agencies of the national government. In addition, they have the right to provide services and build institutions not contemplated by the statutory bodies. They thus pursue, simultaneously, area-based economic development and the local, integrated implementation of national programs connected to it; and they do so in a way that blurs familiar distinctions between public and private, national and local, and representative and participatory democracy.

The preliminary results of this deliberate effort to foster development and welfare through new forms of public and private local co-ordination are extraordinarily promising, if still inconclusive. In eight years of operation, urban partnerships have developed innovative techniques for retraining and placing the long-term unemployed and building potentially self-sustaining firms that provide both training and jobs for them. They have also established new programs to help early school leavers and single mothers, and to encourage community policing and the management of housing estates by their tenants. Rural partnerships have found ways to increase employment opportunities for under- rather than unemployed groups, and to rebuild communities depleted by outmigration.

Together these innovations may form the foundation of a new model for transferring marketable skills to vulnerable groups and communities, unexpectedly providing the opportunity for them to participate in the kinds of activity broadly characteristic of the modern sector of the economy, from which they are normally excluded. These innovations, moreover, are accompanied by local proposals for adjustments to the rules governing eligibility for social welfare benefits whose purpose is to make participation in the new programs broadly affordable and attractive, and to remove the disincentives that often deter the most needy from exploring their possibilities. All of this activity grows out of and reinforces an exchange of views and proposals between public and para-public agencies and the persons who use their services that is subtly reshaping their shared understanding of which local problems to address and how. One result of this mutual dedication to an urgent, common task is remarkable care in the use of resources and, so far, avoidance of the self-dealing that might jeopardize the reform project.

But these promising beginnings are little more than that, and many of the harshest tests of the partnerships and their innovations surely lie ahead. The threats to their continued vitality and expansion are many. First, there is the vulnerability that results from the partnerships' anomalous character. The discretion they exercise in the control of public resources is nowhere authorized by precise administrative rules nor sanctioned directly by the vote of concerned citizens, or even indirectly through a mandate from their local elected representatives. Second, there are the vulnerabilities associated with the confusing profusion of new, self-avowedly innovative institutions, some with overlapping jurisdictions.

But if governance seems a necessity given legitimate public concern, it also seems an obstacle to the innovative character of the framework itself. The traditional way of preventing corruption and assuring the fidelity of execution of programmatic intent is by means of elaborate rules. The rules specify in detail the characteristics that firms or other actors must exhibit to qualify for the program (SME's with at least 20 employees but less than 200, with at least ten percent of sales in export markets), and the services provided (letters of credit or other trade finance). The program is well governed if the rules capture the government's intent, and were consistently applied in choosing beneficiaries and providing the services. But how do you write rules when you want firms to look for trouble, discovering along the way the characteristics of the beneficiaries-to-be and the benefits they will need? It seems you have to choose between having the rules the public legitimately demands and having the program that serves the public need.

Having no rules, our official knows, is simply no option. Without rules corruption runs wild (rule of law tradition or not), as every firm with a friend in the right place can qualify as looking for trouble. What about some middle course between traditional rigidity and a flexible free for all? The obvious possibility is requiring firms extensively to document their ability to detect and correct problems. But if this solution address some of the worry about corruption, it creates new problems with the second concern of governance: legitimacy and fairness. Why have a framework program for firms that have already mastered the new learning-economy disciplines? Isn't reinforcing the few virtuous circles amidst the many vicious one—giving to the rich in a poor country—itself a form of public corruption?

The solution to the problem of corruption, and in large measure the problem of fairness, lies in the precise nature of the services to be provided under the framework program. Very generally, we just saw, the goal is to get and keep firms looking for trouble, typically by giving them an opportunity to learn something to points to a problem and correction at once. Subsidies of this peculiar activity mitigate the accountability problem in two ways. The first is the dis-incentives they create for usual kinds of self-dealing. A subsidy that reduces the cost of looking for improvements has no value unless a firm is, or suspects it is, actually interested in improving. For example, a subsidized visit to a competitor's plant in a distant industrial town is as unappealing as an unsubsidized trip if a manager thinks he has nothing to learn, or that his firm couldn't benefit from new knowledge if it were there for the taking. Indeed, under those conditions even a free trip—a junket—would be a cost, as it reduces the time available for working down the list of urgent tasks. Whereas a subsidy to labor or finance costs can easily be diverted to cover a part of the firm's on-going expenses, subsidies to look for trouble are likely to be valuable to, and to attract firms that want to use the help for the purpose intended.

Second, looking-for-trouble subsidies mitigate the accountability problem by encouraging transparency. Looking for trouble means comparing one's activities with those of others. It is reasonable to ask potential beneficiaries of programs that encourage this to demonstrate their intentions by beginning to take stock of their circumstances, or saying how they intend to do so. After they have done some looking it is reasonable to ask them to say something about the problems they found, and what they intend to do about them. Conversely, actors who give no indication of being able to take even the first steps towards some kind of self analysis are unlikely to benefit from programs that encourage them to do just that, and actors who can't say what they learned from some kind of comparative self study probably didn't learn very much. Between the disincentives they offer normal subsidy hunters, and the (partially) self-policing documentation that they easily elicit, innovative frameworks may thus be less vulnerable to corruption and self-dealing than their open, apparently unruly character suggests.

The nature of the new framework also goes some to the way to addressing the problems of fairness and legitimacy. The looking-for-trouble programs aim to encourage improvement, regardless of starting point. Weak companies should have an easier time making a case for assistance than strong ones because in theory they have an easier time documenting the gap between current and best, or simply competitive practices.

The obvious limit of this argument, hinted at several times above and anticipated in the story of the two family-owned garment firms, is that a company can be so weak that it can not begin to point to the possibilities for improvement. Such a company is too weak, in other words, to ask convincingly for aid in determining the kind of aid it needs. From previous chapters it is clear that there are, especially like states like Michoacan, but scattered throughout the rest of Mexico as well, many companies and public institutions in this category. Asking them to apply for participation in the framework by undertaking some kind of self diagnosis is to exclude them from activities that might benefit them as much, if not more, than the better endowed.

Here additional resources are crucial. The background assumption to this point is that the crucial difficulties facing economic-development policy concern institutional designs, and the political struggles associated with changing them. The real challenge our study shows, and our official's horseback empiricism tends to confirm, is to build institutions that can help economic actors rethink assumptions, then respond institutionally as the assumptions change. Doing this is difficult given entrenched interests and familiar ideas of how to conceive development assistance. But it is not necessarily more expensive than current programs. Indeed, given the shortcomings of the latter and the way the former draw on the knowledge of the actors themselves, it may well be cheaper. But that does not mean it comes for free. In the case of weak firms or other actors more intensive tutoring and monitoring is probably necessary if they are to take part in the framework program. In any case acknowledgement of the possibility, and provision of funding the supplemental services if there is demand for them, is for understandable reasons likely to be a condition of the legitimacy and political acceptability of the innovative framework programs.

4. 3 New Decentralized Framework: Three Principles

From these general considerations it is easy to sketch the bare-bones structure of a new economic-promotion framework that will help to fill in the institutional gaps left by the paucity of connections among Mexican firms and between them and foreign corporations that have located plants in the country. Unsurprisingly, it will resemble a stylized version of the success stories that helped inform its design. More exactly, it will resemble of family of stylizations of these stories, each suitable to particular background conditions. Cutting the Gordian knot of complexity with the sword of simplification is, our official has taught us, the way to get from reality to principle. The way back is by way of multiple exemplifications, especially when the master principle is that, in reality, all principles have to be corrected in practice. Here, then, are three sketches of economic-development programs that illustrate what frameworks for the construction of institutional infrastructure could look like today in Mexico, and many other places as well. The can be read as a sequence starting from the undemanding background conditions and proceeding to—indeed helping to create—more robust ones. But it is possible to see them as proposals for concurrent and mutually complementary endeavors as well.

A. The Matching Grant

Under this program the federal government simply agrees to match every peso, up to a certain limit, that state governments dedicate to economic-development projects decided in collaboration with private actors, on condition that those actors match the state contribution as well. The idea is simply that if the regional government and economic actors are willing to put their own money at risk to finance the projects they define together, then the federal government can assume that their choices are well considered, and add its backing as well. The advantage of this method is to impose some discipline on project selection with almost increase in red tape. The economic actors, public and private, at the regional level are given an incentive to sort through their priorities—start looking for trouble—and the federal government limits itself to ratifying their provisional decisions as they emerge. One shortcoming of the program is that it foresees next to no sharing of experience at the national level, and little formalization of the experience shared in arriving at projects regionally or locally. Word of success presumably gets around—our official is not the only one on horseback these days--but the process of deliberation about what projects to choose, and which are in fact working, remains a black box from the official point of view. So political and bureaucratic meddling is discouraged, but at the price of a kind of willful ignorance of what the actors might be learning.

The second drawback is simply that the framework funds those who are on the verge of funding themselves. It thus comes close to violating the fairness requirement even though its operation is nothing but even-handed in the way it treats (the fortunate) likes alike.

B. The Business-Climate Ranking System

The second framework is also aims to discipline project selection while holding bureaucracy and the politics of clientelism generally in check. But it does this not by ratifying the actors decisions, but rather by providing information on economic performance that cause them to reflect on their possibilities in new ways.

The crucial information intervention could be the creation of a league table of regional economic performance, including, for example,

1) Business registration – cost (for all areas, cost includes in time and formal and informal types of payments and contributions, including bribes), procedures required, delays

2) Business licensing – numbers and types required, cost, time and payments required

3) Obtaining business premises – procedure, costs, constraints, delays

4) Import and Export regulation, Customs – procedures, costs, delays

5) Product, input and equipment certification – types, incidence, procedures, costs, delays

6) Tax administration – requirements, constraints, costs, and number of taxes and forms

7) Business inspections – types (and agency responsible), costs, number, process followed

Beginnings of such a ranking already exists in the comparative rating of regional creditworthiness established in April, 2000 to facilitate loans to sub-national governments, and of course to induce those governments to behave in credit-worthy ways. It is a short step from this ranking system to one that considers in effect the "business climate" of various states. Such a comprehensive ranking would direct the attention of funders looking to establish frameworks of the like discussed here to some places before others; conversely, it would induce states to begin reshaping their economic-development and other programs in ways that would attract the right kind of attention through improved rankings. The strength of this program is that it emphasizes—indeed depends crucially on—information pooling and the common evaluation of experience. One obvious shortcoming is that it requires a kind of modern Lykurgos: a wise lawgiver who sets the initial criteria to favor the "right" programs, then allows the magic self-reinforcement to work. A second limitation is that this kind of programs like the co-investment schemes just noted, favors the fortunate, and weaker states are likely to be rationed out of the competition.

But this second difficulty, at least, appears to be manageable. In the case of the newly minted program for benchmarking the creditworthiness of sub-national governments in Mexico, for example, a first solution has been to adopt a three-tier approach to lending. By law, sub-national governments in Mexico can not borrow from foreign lenders. A new regulatory regime for private banks links their reserve requirements to the risk rating of their prospective public-sector borrowers. Loans to the least risky public authorities require a reserve of 20 percent of the loan amount, whereas the reserve requirement is raised to 115 percent of the amount lent to the most risky customers. To ensure that all relevant loans are reported to the federal authorities and available to the outside agencies that actually rate creditworthiness, all unregistered loans are assigned a prohibitive reserve requirement of 150 percent.

The upshot of the system is to match borrowers of all levels of creditworthiness to the type of lending institution best able to serve them. The lowest-risk public entities are reasonably the province of domestic private banks, which have neither the competence to provide technical assistance to distressed borrowers, nor the political power to resist the machinations of local governments that fall behind in their debt service. Higher-risk borrowers, with reserve ratings of up to 100 percent, are served by federal development banks, which have experience in dealing with vulnerable but well intentioned borrowers. Finally, sub-national loans with risk weightings of more than 100 percent are allowed if the loan package contains a technical assistance component funded by an international development bank. In this way parties—and potential parties—on both sides of the transaction know what they are getting into, and take precautions accordingly. In time, furthermore, the benchmarking criteria can be refined in the light of lending experience, and the technical assistance programs can themselves become open-ended frameworks that use the refined benchmarks as reference points for creating additional programs with vulnerable SMEs.

Box 4.2 Co-Investment and Business-Climate Ranking as Criteria for Funding Provincial Public Works in Argentina

Elements of the first two models have come almost unintentionally to inform a successful program under which the IBRD and then the IDB provide low interest, long-term loans to provincial governments in Argentina. The loans fund administrative and fiscal reforms or public works. Three general and conventional rules set by the multi-lateral agencies govern the allocation of funds among competing provinces. The first imposes an extensive requirement to co-invest: provinces must offer a share of its *coparticipación* tax revenues as collateral to the general loan fund, co-finance (50%) of any public works project, and finance and staff the provincial implementing units. The second establishes thresh-hold requirements for macro-economic performance: to access loans for public works (new or in progress), participating provinces must meet two strict criteria – a current account fiscal surplus and a level of debt service that is less than 15% of current revenues. Performance on both accounts must be reported to a federal Project Implementation Unit (PIU) by the province in its Financial Action and Investment Plan (PAFIs). If a province fails to meet these two criteria, it must develop and implement with the PIU a new financial plan (including debt refinancing, improved local tax revenues, restructuring of expenditures, etc.) before a loan is granted. The third criterion concerns the utility of the projects. Thus projects to build or improve schools, hospitals, sanitation, or other infrastructure, must demonstrably augment the capacity of provinces to take on the programs that are being decentralized to them from the national government. Fourth and finally, successful applications document how the proposed project will meet current standards for accounting, financial management, bidding, and contracting.

It is the innovative role of the federal PIU, financed mainly by a small percentage of the loans, that makes the loan program distinct in a way that illustrates the potential use of co-investment and benchmarking as instruments of developmental learning. Formally the PIU acts as an agent of multilateral lending institutions and as a monitor and service provider for both the national and provincial governments. In practice, the PIU is responsible for monitoring the fiscal performance and projects of the provinces via the PAFIs as well as presenting recommendations to the Creditors Committee on the approval or rejection of PAFIs and projects. The PIU currently has a staff of about 100 provincial and technical/functional experts in areas such as accounting, contracting, architects, engineers, who PIU provides free technical assistance to the provinces.

Because of its central position, and ample staff, and because the line between monitoring and assistance is often blurred, the PIU is often more engaged in benchmarking and teaching than monitoring of contract compliance. For instance, when a province is unable to meet the above-mentioned fiscal criteria, the PIU assists the province in reorganizing its finances and identifying solutions to, say, improve the revenue base, and thus aids in the development and implementation of a new PAFI. Third, the PIU organizes and co-finances (with the provinces) training programs for provincial managers and, occasionally, relevant civil servants of the provincial administrations.

The central role of the federal PIU unit has thus come more and more to be that of facilitating learning between provinces, and improving both its monitoring and technical assistance methods. In addition it acts as an effective interlocutor between the provinces, multilateral lending agencies, and the national government have been in the innovations in the governance structures and the incorporation of benchmarking. In adopting modern benchmarking methods, the PIU conducts periodic, structured comparisons over time and between provinces. In so doing, the PIU learns how to improve its own project and PAFI evaluation procedures and technical assistance as well as helps the provinces learn from one another and adopt preventive strategies. As it demonstrates its ability to monitor and assist the provinces, the PIU, in turn, has built up reputational capital vis-à-vis private creditors (i.e., in mediating for provinces for new non-program projects) and the IBRD/IDB (i.e., in presenting proposals for changes in project criteria and monitoring rules as well as new provincial-level programs).

C. Competition for Open-Ended projects

As the second, benchmarking-based type of framework program develops, adding technical services and becoming self-reflective about benchmarking criteria, it naturally grows into a third type of program that we will call contest-based and open-ended. This type of program starts out by assuming what the second winds up discovering (and what the first may never learn at all): that the benchmarks used and selection criteria, and the technical services provided to those who rank badly in the league tables, are provisional solutions, in need of continuing correction in the light of the learning that they enable. Whereas the first two types of framework programs permit and encourage looking-for-trouble projects, the third type, aware of its own limits, is anticipating in its design trouble with itself, and seeking ways to respond to the difficulties encountered. It uses benchmarking both as a way of selecting projects and as a way of forcing discussion about the criteria of project selection. Very generally it operates on two levels: At the "top" a benchmarking committee of the relevant government entities and qualified private actors, domestic and foreign, collaborates with potential users to establish the initial substantive and procedural criteria for participation, and defines the initial metrics by which applications are to be ranked. At the "bottom" project groups compete to present projects that score highly under the emergent criteria. After each round of projects the selection criteria and benchmarks are adjusted to reflect improved measures of performance and a richer understanding of success. At least two variants are imaginable, depending on whether projects concern states or other broad jurisdictions of government on the one hand, or groups of firms typically operating in many different political jurisdictions on the other.

Consider as an illustration of the first possibility a national program to improve the business environment along, roughly speaking, the seven dimensions listed above. As the states by their particular regulations and practices define distinct business environments, collaborative elaboration of benchmarks and selection criteria will necessarily entail a joint effort by representatives of the states and representatives of national institutions, augments by the relevant private-sector actors. Project funds are then allocated to states according to the criteria and actual rankings; states will then allocate the funds they have received to individual projects, applying the national procedures and criteria where appropriate and augmenting these with local ones as required. Competition for funds drives efforts at improvement. States that do not rank well initially—and projects within high ranking states that fare poorly in early selection rounds—will be eligible for technical assistance according to criteria established again through national and local collaboration. The types of technical assistance provided, and the level at which they are funded, will be adjusted in a rhythm synchronized with the revisions of the performance metrics and selection criteria. There may emerge a match between certain types of service providers and certain groups of clients along the lines of the banking example introduced a moment ago; but the creation of such links will be a result of the operation of the framework, not a design decision.

The supplier-improvement project works in a similar way, except that there are no block grants to the states or any other sub-national jurisdiction as such. But this does not mean that the public-sector is excluded from the program. On the contrary: groups of firms will presumably partner with various government entities as well as with each other in applying for support directly to a national selection committee. For its part that committee makes (improvement of) the breadth and depth of public-private relations in this regard one of its principal selection criteria. (CONACYT already administers a related program for technology modernization in which groups of firms in partnership with local governments compete for aid on the basis of jointly developed programs. Perhaps the most effective provider of technical services to firms in Chihuahua was constructed through this program.)

The disadvantage of this third type of open-ended program regards governability. The constitution and operation of the criteria-selection committee creates opportunities for abuse that are avoided in both the matching-grant and once-and-for benchmark schemes. The dangers can be in part mitigated by emphasis on procedures: making the use of transparent methods for selecting program officers and project members a formal criterion for selection, and then using the information that these procedures produce to identify suspect operations. And again the nature of the projects themselves and the information that they produce about interim results reduces the threat of corruption or cronyism. Active involvement of outsiders with incentives to denounce collusion can help as well. But all these are palliatives, not cures, and it may be that open-ended, competitive frameworks are best developed on the basis of the experience accumulated in various combinations of the less burdensome types.

The learning economy, we have been arguing, is first and foremost a response to pervasive ambiguity and the increasing contestability of economic and political and economic actors to which it gives rise. The ambiguity, and the resulting vulnerability to new competitors, concerns what to do and how to do it. In the face of this deep ambiguity firms resort to complex and changing forms of co-design and co-production, constantly searching out partners who can do with them what they can not do alone or in closed groups. The creation and renewal of the necessary collaborative relations requires in turn that firms discuss with one another what to produce and how as a condition of competition. Facilitating the creation of the standards and other languages that make this discussion possible, and making the discussion itself accessible to actors who might be excluded from it if left to themselves, has become one of, it not the chief, contribution of government to economic development broadly conceived. Indeed, governments at all levels are increasing being forced by the new conditions of competition among firms to compete amongst themselves in providing the corresponding services.

The Mexican economy is a case study in the growing importance of this new kind of government action, and of the possibility of providing it. Mexican firms are too often cut off from each other, from capable foreign corporations operating in Mexico, and from government agencies directed to help them make the connections they lack. But that is not the whole reality. For in Mexico there are as well many examples of sub-national programs that do indeed help firms and public entities find the troubles that lead to improvement, including improvement in the way trouble is found. In that sense Mexico stands at the cross roads that marks the condition of most of the major economies in the world that can still usefully be called "developing": It has demonstrated the capacity to connect to world markets and compete in them, even if the connections are spare. It has demonstrated a capacity for public action that could be turned to correcting the deficits remaining, even if the balance of public action so far is a strong argument against more of the same, whatever, exactly, that may have been.

Framework programs, constructed from institutions already in operation, allow public and private actors to respond to the demands of the moment without having to pretend that their initial choices somehow escape the ambiguity that confounds all others. Moreover, and crucially, they help the actors address the governance questions that their openness creates. And they do is in a way that also allows the actors to acquire the capacities they need to reach their goals even as they help them fix the goals themselves. In this sense help create sets of incentives and capabilities that lead to effective action.

But however much frameworks create, they do not create themselves.

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Chapter 5: Transition to the New Decentralized System

5.1 Transformation to the New System: Principles

The center of action of the decentralized system discussed in the previous chapters lies in the states and at the local level. But the Federal government has a critical role to play. That role is very different from the role as central actor, which it played in the strategy of import substitution earlier in the century. But it is also very different from the preoccupation with macro-economic management, international economic relations, privatization and deregulation that has characterized federal policy in the last decade and monopolized the most talented government officials.

The new role of Federal government is threefold. It is, first, to promote the process of discussion, debate, and discursive problem solving at the state and local level. This process will result in private-public initiatives – entry points to unleash private sector dynamism. Second, it is to support that process with technical assistance and the mechanism of evaluation, continuous improvement and program innovation. Third, and most importantly, it must draw into this process a well-trained and committed group men and women of the caliber of those which in the past supported state-led import substitution and, in the last ten years, devoted their talent to macro-economic management, privatization, and the negotiation of international treaties. It is to facilitate national process of deliberation and sharing of knowledge about promising state and sectoral initiatives involving all strata of civil society, private sector and the governments. Such a process, although it may not necessarily be an immediate priority, be called Mexico 2025.

In this chapter, we will discuss all three elements focusing on the key elements of such a Federal government policy.

The policy proposed here implies nothing less than a whole new strategy for private sector promotion, although the transformation which that policy will bring about will consist of continual and incremental changes rather than a comprehensive, linear action.. The policy is premised upon four basic background conditions:

- Macroeconomic stability and growth, to avoid crowding out of private investments,

- National consensus around the idea that horizontal industrial promotion plays a strategic role in economic growth, social cohesion, and political development,
- Continuous and consistent government support for and prioritizing of reform of the industrial promotion.

In spite of the variety in project content and methodology, there will be several commonalties that should be based on new criteria for private sector development, both at the system level and at the level of the actors:

- A consensus must be built in the process of defining national private sector policies.
- Decentralization will increase responsiveness to societal demand.
- Programs should be based on incentives, information sharing, and evaluation, and should demonstrate efficient use of resources.

Experimentation and incremental improvement should be stressed, making transition to the new system a process of social learning. These criteria must serve to unify expectations, goals, and performance in the sector. This approach to reform could be, in its essence, an incremental inductive process of system-wide transformation. In the remainder of the chapter we outline the basic structural components of the new policy.

The policy framework would have the following basic structure:

1. It would make a sharp distinction between facilitation and elaboration of initiatives and projects of and their implementation.

2. Each of these components would have its own distinct process policy making process and a separate and distinct administrative procedure for funding, and for evaluation.

3. Elaboration of initiatives would take place at the state level, but initiatives, projects and programs are funded (or co-funded) and evaluated by the Federal Government.

4. The Federal Government would also provide promoters (who would help promote the participation of civil society) and technical assistance but at the request of the state.

5. Initiatives will be administered at the state level, <u>but</u>

6. With mixed financing from the federal and state governments and from the private sector, <u>and</u>

7. With a limited number of specific programmatic components provided by the Federal Government.

8. Both the Federal and the State government would be required to set up mechanisms of evaluation and continuous improvement.

To implement a program of this kind, existing polices need to be reoriented in the following ways:

At the Federal Government level, it will require:

- Consolidation of existing programs.
- Making Federal programs driven by the demand of the states and private sector clients.
- Making Federal Budgeting flexible, capable of adapting to demand and building upon experience, and mixing its funds with those of other sources as outlined below.
- Building in mechanisms for evaluation, for the identification of best practices at the state level and for collecting, evaluating and disseminating international experiences.
- Built-in feedback from the state in a process of continuous improvements of their tools.
- Attracting top caliber talent to promote and facilitate the planning process, to administer operating program and to guide experimentation and evaluation.

Finally, the Federal government has to provide financial support while, at the same time, avoid exclusive financing, promoting instead co-financing which mixes its own funds with funds drawn from the private sector, international organizations, state governments, and NGO's.

At the state level, the policy making process should

- Grow out of discussion and debate within civil society.
- Draw upon active participation of the private sector in financing, conception and operation.
- built in mechanism for evaluation and improvement in the light of the state's own experience, experience elsewhere in Mexico, and experience abroad.

Civil society

- The organizations and institutions of civil society particularly business organizations (Camaras) must shift from a passive to an active role.

Now we turn to the specific reforms that are required for the actors to play these new roles.

5.2 Federal level: facilitation and monitoring of state-level initiatives

We devote the most attention here to the Federal Government because it has to be the fountainhead of the new policy, although the States will become the most important actors.

Consolidation of Federal Budget

The debt crisis led to a reduction of budget resources as percentage of GDP, non-financial expenditure[1] dropped from 27 percent of GDP in 1981 to 15.1 percent in 1999[2]. These reduced resources were also redistributed. By the year 2000, private sector development budget had fallen to barely 3.5 billion pesos, the 0.07% of GDP.[3] With this reduced level of expenditure, the Federal Government reduced most of its industrial promotion programs, with the aim that new industrial policy should be based on horizontal policies, where training and technical assistance are the main feature of this policy. This new approach, however left promotion policy without effective central coordination. It is carried out by different Secretarías. Scattered promotion resources are shared by different entities, i.e. training budget is shared by Secretaría de Comercio y Fomento Industrial, Secretaría del Trabajo and Nacional Financiera. This has fueled turf-battle for scarce resources, with a negative impact on efficiency and outreach of PSD programs.

Main Federal Programs are distributed as follows:

- Secretary of Trade and Industrial Promotion has a limited budget mainly for technical assistance to small businesses; the key programs are CETRO/CRECES and COMPITE. Their operation is channeled through alliances with private

[1] Programable expenditure
[2] Estimated from Webpage of Secretaría de Hacienda y Crédito Publico and Instituto de Estadística, Geografía e Informática.

sector chambers in each Federal State, i.e. CANACINTRA. This Secretary has been quite successful in setting up some Internet programs with its limited budget focused mainly establishing international benchmarking data in order to promote world quality businesses.

- The largest budget for training is under the control of the Secretary of Labor and its star programs is CIMO, whose main aim is to certify suppliers quality, so large firms could use them as suppliers.
- The largest budget for industrial promotion is linked to technological development, where the National Council of Science and Technology (CONACYT) promotes prototypes technical and technological improvements.
- Financing to SMEs is supported through Development Banks, where the institutions have a special budget for promotion, beside their credit operations. NAFIN budget is mainly for technical assistance and BANCOMEXT supports technical assistance for export promotion direct or indirectly.

Table 5.1 below provides a summary of the programs and shows how promotion budget is shared among the different public entities. The largest share is training grants, with one half of the budget, followed by support of technological development, Nafin is third and different institutions share the rest.

Table 5.1. Federal Government: Industrial Promotion Budget
Million of pesos

	1996	1997	1998	1999	2000	% of total	% of GDP
SECOFI					**284.2**	**7.5**	**0.0054**
Promotion Areas Budget					**135.0**	**3.5**	**0.0026**
Promotion Undersecretary					75.0	**2.0**	**0.0014**
'-SME Directory					25.0	**0.7**	**0.0005**
Promode					15.0	**0.4**	**0.0003**
Commercial Registry					20.0	**0.5**	**0.0004**
Training and Technical assistance/1	**2.6**	**101.8**	**104.5**	**129.7**	**149.2**	**3.9**	**0.0028**
CETRO/CRECE	0.0	100.3	97.2	109.3	129.0	**3.4**	**0.0025**
COMPITE	0.0	1.5	5.4	15.5	14.0	**0.4**	**0.0003**
Others	2.6	0.0	1.9	4.9	6.2	**0.2**	**0.0001**
Technological development/2	**683.8**	**478.8**	**464.9**	**527.4**	**741.9**	**19.5**	**0.0142**
FIDETEC				32.6	84.5	**2.2**	**0.0016**

[3] In the United States economic promotion budget is of around 28 billion dollars, that will mean 0.27% of GDP, four times larger than in Mexico.

PCI-Conacyt/3	415.8	209.0	227.0	237.0	267.8	7.0	0.0051
Cenam	165.5	136.5	154.1	114.1	165.3	4.3	0.0032
IMPI	102.5	133.3	83.8	143.7	224.3	5.9	0.0043
Training grant					1933.5	50.8	0.0369
CIMO					283.9	7.5	0.0054
Sinorcom					148.4	3.9	0.0028
Probecat					1501.2	39.5	0.0287
NAFIN/4	/5	/5	5.0	6.0	6.0	0.2	0.0001
Environment improvement							
SEMARNAP					20.9	0.5	0.0004
Exports Promotion							
BANCOMEXT					70.5	1.9	0.0013
Industry-school linkage							
SEP/Conalep					392.3	10.3	0.0075
Total	686.4	580.6	569.4	657.1	3449.3	100.0	0.0659

Sources

/1 Proyecto de Presupuesto de la Federación 2000 Chart III.32

/2 Proyecto de Presupuesto de la Federación 2000.Chart III.33

/3 Source: Conacyt. Conacyt has a credit line up to 300 million dollars with the World Bank to support technical development, science, and budget to promote links between University – Industry. Spending on this items is subject to approval by the SHCP, following a mix-up of resources of 60% World Bank and 40% Federal Government.

/4Nafin uses a fund for technical assistance, that includes overhead

/5 In 1997 Nafin restructured the promotion area that supported Negocentros in the first half of the nineties

The first step in reorganizing federal programs would be to consolidate the federal expenditures so that all programs are grouped together in a single budget. Ideally that budget should be administer by one single agency as well, but administrative consolidation may not be possible initially. The policy making process should nevertheless be organized around a consolidated budget.

The second step in the reform of promotion policy would be to divide the consolidated budget into three broad functional categories: planning, operations, and administrative support for program evaluation, technical assistance and promotion.

The planning function and budget would be almost completely decentralized to the states. Operational funds would be allocated to the states through a voucher like system, which would enable them to purchase program components from Federal

Agencies. Federal Government would retain responsibilities for Program Evaluation, technical assistance and promotion, and set up new mechanism to accomplish these tasks.

Although existing programs would be retained initially, a certain portion of any new operating funds would be set aside for experimental programs to be awarded to states on the basis of competition.

Federal Government would set up a system of evaluation, which would be used both for monitoring and improving the performance of program components "purchased" by the state under the voucher system and for judging competitive state proposals.

Federal funds should be distributed to the states through a Trust Fund System, which would enable them to come mingled with other sources of funds and avoid bureaucracies red tape and delays.

States should be required to present a plan approved by the Federal Government to obtain access to funds for operating programs. A fund for technical assistance will be constituted at the Federal Government, in order to support this planning process and guarantee equity in budget assignment.

The administrative and support responsibilities of the Federal Government will be divided into four major components; one would be technical assistance, a second the creation and maintenance of systems of evaluation, a third the support of advisory groups and a fourth, the creation and training of a staff to promote and facilitate elaboration of private-public initiatives at state level. Section 5.5 blow elaborates on institutional design of the system.

5. 3 State level: private-public initiatives

Our models for the structure at the state level are those of Jalisco and Chihuahua discussed in Chapter 2. But each state will need to develop a planning process and administrative structure appropriate to its own economic circumstances and political culture and should have wide latitude to choose the forms which these will take. They should nonetheless be required to meet three broad criteria in order to receive federal approval and support:

- Broad based participation by the various sectors and organizations of civil society in the planning process.

- A single agency with accountability for program coordination and administration (This agency will assume responsibilities now exercised by state level representatives of Federal ministries, which will presumably be abolished).
- A set of structures and procedures designed to insure private participation and systematic program monitoring and evaluation. The monitoring scheme should provide for benchmarking, be organized around annual goals, and include provisions for redirecting funds if goals are not achieved. Evaluation could become the main method to legitimize the decentralized promotion scheme, and will avoid mismanagement of resources at local level.

Budget assignment and preparation would be based on the constitution of a National Advisory Council at the Federal level with analogous councils at the state level. Councils should be composed of representatives of government, of the private sector, and of the different social actors. The Federal council will be primarily responsible for the evaluation of state plans and for mechanism of program evaluation. Councils at the State level will evaluate the projects, which will require a cooperative approach between private and public sector.

Federal funds should be distributed to the states through a Trust Fund System, which would enable them to come mingled with other sources of funds and avoid bureaucracies red tape and delays.

States should be required to present a program approved by the Federal Government to obtain access to funds for operating state-level projects and programs. A fund for technical assistance will be constituted at the Federal Government, in order to support this planning process and guarantee equity in budget assignment.

Capabilities of State governments and local private sector, and their ability to work together would determine scale and scope of decentralized programs in practice. One can argue that in States where private sector capabilities for collective action is strong while that of the State governments are relatively weak the focus should be on demand-driven centrally financed program rather than decentralization per se. Mexico is characterized by a wide diversity of capabilities of sub-national governments and the private sector. In some States (e.g. Nuevo Leon) private sector is stronger than the government, while others (e.g. Oaxaca) are characterized by the reverse situation. Table 2 summarizes the diversity of local capabilities.

Table 5.2
Sub-National Governments and Local Private Sector: Matching Role to Capability

	Private sector capability – strong	Private sector capacity for collective initiative – weak
Sub-national government capability – strong	**Private-public decentralized programs** elaborated by local private-public partnerships and financed by sub-national governments (Northern and Central States)	**Government-led decentralized programs** Locally-tailored programs (promotion of local industries) (Oaxaca, Puebla)
Sub-national government capability – relatively weak	**Private-sector-led design of centrally-financed programs** Promotion of backward linkages, Technological and quality infrastructure (Nuevo Leon)	**Demand-driven central programs** First-come, first-serve matching grant schemes (similar to CIMO program) (certain States of the South-East)

5.4 National process of deliberation: toward shared vision Mexico 2025

Each state and locality will have its own structure and particular set of economic and political actors, which will need to be drawn into the development process, many of these actors will need to be restructured and reoriented to assume a proactive role. But the major obstacle to the development process, which we are envisioning here, is the organization of the business community.

The current organization of Mexican business reflects the law of the Camaras and the tradition of Federal direction and control of industrial policy in Mexico. In the past the law made membership in the Cameras compulsory, thereby guaranteeing their funding and the Camaras function primarily as a lobby, working to obtain particular federal government's laws and supports in the form of subsidies, tax break, tariffs and other forms of protection.

Under the strategy of free trade and open market the Federal government is no longer a source of protection and direct support to industry. Camara need to play a proactive role, providing the institutional infrastructure for the business community and particular services in the form of training and interbusiness exchange they will strengthen the ability of firms to compete on their own. One of the main reforms of the last

Administration was the amendment of the Law of Camaras, in a way that should have encouraged them to do this by abolishing compulsory membership and forcing them to justify their existence in order to obtain funding. But this law has seen major disappointments, the Camaras has failed to accept their new role. Some business organizations at local level have moved in this direction, i.e. CAINTRA in Nuevo León. As we saw in Chapter II, other Camaras have cooperated with State Governments to develop and implement programs of precisely the kind of programs suggested in this report. But overall the reform of the Law of the Camaras has been a major disappointment. Most of these organizations have continued their traditional mode of operation, lobbying for federal favors. They have lost membership, but they do not know how to adjust to the environment.

The incentive structure created by the new law has not been enough to change the behavior of these organizations in the way, which is required for them to participate in the process of discursive problem solving that we are proposing here. The Federal Government must play an active role in fostering the internal reform. This will be one of the principal responsibilities of the new core of promoters (see Box 5.2 in the next Section).

Interestingly and significantly, an alternative way of organizing private sector to formulate and execute projects which serve its long-term collective needs already exists. This is institution of Consejeros of the largest and the most prestigious private university in Mexico: Monterrey Institute of Technology (*Instituto Technologico de Estudios Superiores de Monterrey – ITESM*). The governing body of the University – *Junta de Consejeros* – consists of approximately 400 local private sector leaders. They oversee existing 26 local campuses of the University and assure that curriculum is responsive to the private sector demand in the area. *Consejeros* catalyze collective action of local private sector leader if a new campus is deemed to be necessary in the community. Private sector leaders must demonstrate their commitment to the local campus by providing physical installations (office buildings and infrastructure). The university does not receive government subsidies and private sector contributions are vital. The fact that ITESM has now 26 local campuses is a best testification of ability of concerned private sector leaders to collectively realize the regional development agenda in their respective localities.

It is not surprising therefore that these 400 *Consejeros* representing all Mexican State and localities were proposing in 1998 to start a highly participatory process Mexico 2020 (similar to El Salvador 2021, Malaysia 2020, Rio Shared Vision) to jump-start institutional experimentation through joint private-public-civil society dialogue. The vision-building processes were supposed to start at the state level and build on highly successful experiences such as Monterrey 400 and Chihuahua Siglo XXI, also facilitated by the ITESM. The basic idea is to unleash creativity of private sector and civil society by jointly elaborating compelling shared vision of the future and implementing the vision through joint projects. As Box 5.1 illustrates, both components – shared vision and joint action are equally important.

Box 5.1 Building Credibility with Tangible Results: Shared Vision Process in Rio de Janeiro

The city of Rio de Janeiro has been in gradual decline since the mid-seventies. In 1993, motivated by the successful vision-building process undertaken by the city of Barcelona (its rebirth culminating in the hosting of the Olympic Games in 1992 and continued dynamism), the mayor launched what has become the most inclusive vision-building process in Latin America.

A very sophisticated marketing operation underlay the entire process. The process initially was driven by a small "promotion group" (three dynamic individuals who have legitimacy within the community -- the Secretary of Urban Development appointed by the mayor as his representative, the President of the Federation of Industries, and the President of the Commerce Association of Rio de Janeiro). Next, a full-time Executive Director was appointed, an individual with tremendous communication skills, with five full-time staff assisted by a team of external consultants. This small Executive Committee had full-time responsibility for fostering the process and drafting the development Plan. The Executive Committee, in turn, reported to a somewhat larger Directive Council (24 recognized leaders of the City, including representatives of trade unions, academia, the private sector, media and government), that met on a monthly basis and acted as de facto a decision-making body. Finally, a City "Council" (a large assembly of 400 individuals representing the broad spectrum of society) met on a bi-annual basis and provided legitimacy to the entire process by examining proposals ex-ante, giving a feedback and formally ratifying key decisions. In terms of financing, the mayor provided basic office facilities and roughly one-third of the project budget.

Importantly, two-thirds of the funding was sought from private sector sponsors: a consortia of 40 firms was assembled with each contributing $1,000 on a monthly basis over an eighteen months period. Throughout this process, the mayor appears to have been able to shield the Plan's development from excessive political influence; in fact, at every possible opportunity, the mayor has emphasized that the plan "is not the mayor's plan but belongs to the City as a whole". The consensual process of drafting the City's strategic plan has taken 18 months from initiation to formal ratification.

The results of this process have been impressive to date, with substantial impact even prior to ratification. Perhaps most importantly, the process of development of the plan has been instrumental in changing the climate of discourse in the City, from one of resignation to one of upward momentum: there is now a consensus that the City has turned the corner and in a strong positive growth phase. The process has been important in identifying critical investments for the City in terms of infrastructure, educational and training needs, and other social development projects, as well as investments in industry and services. A number of major private-public initiatives in distant learning, tourism development, housing and infrastructure are in the making and some already resulted in specific, sometimes sophisticated project finance deals.

The idea of the shared vision Mexico 2020 was discussed at the Junta de Consejeros de ITESM in February 1998 where champions of similar exercises (Malaysia 2020, Rio 2004, Barcelona) were invited to share their experiences. The proposal was made to SECOFI and SHCP on private-sector driven process Mexico 2020. SHCP requested the World Bank to play a role of knowledge broker in the process. A number of seminars co-organized by ITESM, NAFIN and the World Bank revealed the problem of weak federal leadership at that time. Although the ITESM leadership was important, it could not substitute for the absence of decentralized system of industrial promotion. Now when such a system is being elaborated and piloted, one may want to come back to the idea of shared deliberation of the nation's future (which now could be called Mexico 2025) as overarching framework for decentralized system of promotion.

5.5 Institutional design of the new decentralized system

As it has been discussed already, basic institutional architecture comprises the following three elements:

(i) A distinct regulator and financier as third level (tercer piso): National Advisory Council

Ideally, a Private-Public Council with substantial private sector participation would be in charge of defining the rules of the game (Statement of Policies and Operating Procedures), and entrusted with ex-post monitoring control to ensure the well-functioning of all operating procedures. The national institution with a leadership mandate in this area such Secretary of Economy could help by pooling experience so that successful innovations are rapidly identified and failures quickly exposed, and by providing common infrastructure needed by all regional economies in Mexico (for example access to such as Bancomext, Conacyt, Nafin and STPS (Cimo) also would be represented on this Council. As a specific illustration, this Council would ensure that two distinct public entities do not offer similar programs with differing subsidy rates. Private sector participation is essential to ensure transparency, with conflicts to be resolved by the Presidency. The Council will accelerate formation of champions – elite group of people comparable in terms of talent, training and dedication to those who directed opening to trade, privatization, deregulation and the negotiation of international treaties but now working on issues of institutional development and industrial promotion (Box 5.2). The Council will also administer allocation of funds between the states, the basis of contests or matching grants (Box 5.3).

Box 5.2 Promoters

As noted in the text, the new policy needs to be supported by a corps of men and women, comparable in terms of talent, training and dedication to those who directed opening to trade, privatization, deregulation and the negotiation of international treaties with the United States and the European Community. A model program to create such a corps would have the following components:

The nucleus of the group would come from people who have already emerged in States such as Jalisco and Chihuahua, which pioneered in the process of discursive problem solving. This nucleus would be supplemented with new recruits, draw from recent University graduates, Mexican nationals currently working in international agencies and masters and Ph.D. returning from study abroad. The salaries scale and reward structure should be competitive with the private sector and for the nucleus of experienced state officials with the position they presently hold.

Initial training should be provided to this group on the model that Harvard University has developed for the orientation of new elected Congressman and Senators in the United States. That model has been extended to train the Staff of newly appointed of International Agencies i.e. Director General of the ILO. A four week program organized and led by a Mexican University is envisaged. While the program would draw on Mexican university faculty primarily, they might be supplemented by guest lectures from business leaders, government officials, and foreign experts. The Harvard model focuses on classroom training in economics and management. The Mexican model should be extended to include direct exposure in the field to operating programs in several different states of the Republic and a similar component exposing the recruits to international experience in at least in one developed country such as in the United States and one developing country such as Chile.

Box 5. 3 Advisory Council Administers Contests between States

1. The main feature of the program would be that states compete among themselves for Federal Fund. The main feature would be that the States will get Federal funds based on the quality of their proposals, so excellent proposals could get more than other States. The baseline will be for states with poor programs, but that were able to design a strategic program, its operation will be based on matching funds that will be provided on equal shares by Federal Government and State government – that will be the formula 1 x 1 funds – excellent proposals will be matched 3x1. National Council would grade the quality of the proposals, based on:

- Quality of Strategic proposal for state development.
- Co financing formula, based on the additional funds that state government could provide from a cooperative approach with the private sector or eventual donors.
- Capacity of the state to assume operative responsibility on promotion.

- Levels of the promotion budget of the state to develop entreprenuership: adequate infrastructure, expenditures in technical training, etc.
- Willingness of the state to contract debt to leverage the promotion subsidies.

Initially there will be supportive actions that will not use necessarily the matching fund formula, but instead a formula of distribution of fund among states in accordance with their performance in the use of promotion subsidies.

2. The National Advisory Council would be conformed by private and public sector, and their counterparts will be the State Councils of Entrepreneurship Promotion. Private sector should have a more active and institutional representation in the Council, each estate will have a different composition accordingly with their own private-public organization.

3. A trust fund will be created to provide financing to the activities chosen under the Strategic Program for Entrepreneurship Development. The Fund will be supported by national and international funds, and will provide matching funds, credits, guarantees and venture capital.

4. Councils Technical Committees will seat private – public sector representatives and members from the academia and other representatives of the civil society.

Programs will be demand driven, so their main feature is that they will respond to the needs in each state. National Advisory Council will set the guidelines for preparing the programs, but they will be general and flexible, trying to capture state environment.

(ii) An **independent management unit as second level (segundo piso):** To ensure that there is no conflict of interest regarding how to give out funds, the unit responsible for administering resources and intermediating between supply and demand ideally should be credibly independent and follow transparent Operating Procedures for resource allocation. The resource allocation procedures should be designed to minimize any tendency for corruption and clientelism, and could range from (a) first come first served , to attempt to minimize discretion in the allocation of subsidies to (b) a more elaborate contest where entrants (enterprises and associated public and private service providers) would have to explain their accomplishments to date and how new activities could strengthen themselves, existing institutions and the economy. The management unit may also be responsible for actively promoting the benefits of utilizing support services and for hand-holding advice on the process of using support services (for instance on how to decide the type of service that would be most beneficial). There are at least two current management unit models in Latin America, (a) the use of an externally-hired contracting company under a Management Service Agreement (Argentina; generally backed up by the resources and reputation of an international consultancy) and (b) the development of an appropriate independent local institution with complete financial and operational autonomy from the government (Chile; the Productivity Center, Cepri, in some senses perhaps the closest analogy to the Mexican CRECE). A somewhat different model that stresses re-direction of existing institutions envisages that the local management unit could be in the form of a committee composed of representatives of existing service organizations, potential new entrants, and qualified representatives of private firms (such as the director of the purchasing department of a multinational with long experience in the new supplier relations). Initially, Ministry of Economy and Trade (Secofi) can play the role of independent management unit.

(iii) **A diverse array of national and international service suppliers as first level** : These are generally private sector consultants, but could also include public sector service providers as long as they charge for their services and compete on an equal basis with other private providers. As a guarantee of the relevance and need of any service to be provided to the enterprises themselves, it would be a pre-requisite that the enterprises contribute a strong element of own private financing, typically at least 50 percent towards the costs of fees and associated expenses of external support services.

Implementation. Although there may be agreement that certain characteristics such as a decentralized demand-driven mechanism are generally desirable, it would be important to test different approaches in different localities under one general umbrella demonstration program. A few examples include: **existing/restructured institutions vs. external contractor as management unit** -- One important distinction between different approaches is the extent to which emphasis is placed on building institutions within the enterprise versus also external to the enterprise. One view is that if the objective is to increase all effort should be focused on institution-building within enterprises. The implication of this view is that efforts at trying to strengthen or restructure existing institutions external to the firm reduce the amount of resources available directly to firms, and therefore it would be more cost effective (since reforming old institutions is difficult) to simply rely on an external contractor as the management unit . An alternate view is that one of the key challenges in Mexico is to make support institutions that already exist work better, rather than building new institutions from scratch. During the demonstration phase, it may be desirable to test various alternative forms of management units.

Following preparatory discussions in various localities, it may for instance be decided that Caintra would be an appropriate choice as management unit in Monterrey (or perhaps more than one institution; or perhaps a committee composed of local representatives of various public and private institutions), with individuals currently working within Cimo s UPC and other public entities de-facto privatized and working as first level direct service providers and sub-contracting to other national or international consultants where appropriate. On the other hand, in a region with weak local institutions, the independent management unit may be a foreign private contractor (who then progressively substitutes local for foreign staff as knowledge is transmitted). As a general rule, institutional creativity is the name of the game. A transitional scheme may be required to gradually transfer financing and service provision from Federal level to sub-national level and to independent service providers (Box 5.4). Annex 3 (in Spanish) elaborates on institutional details of the proposed decentralized mechanism.

Box 5.4 Transitional Scheme to Allocate Funds to States

The following is a proposal for the transition of new system of Federal Programs responsive to state demands:

The basic idea is that Federal funds will be allocated directly to the States, but the States could only use these funds to purchase federal programs and the Federal Agencies would have to obtain their budget allocation from these state purchases. Practically the program would work this way:

1. Federal agencies will start initially providing the existing menu of programs.
2. The present budget of these programs would be converted into virtual vouchers on a peso for peso basis, i.e. one budgetary peso equals one voucher.
3. Each state will receive an amount of vouchers equal to the current budgetary allocation in pesos.
4. The States could use these vouchers to buy programs from the existing Federal Agencies.
5. Agencies could set whatever price they wish for these Programs but presumably they will begin pricing the programs at current cost and raise or low the price in response to demand from states.
6. The Federal Agencies will continue to receive their actual funding from the Federal Government and initial funding would be set at current levels. But ....
7. A virtual profit and loss would be computed for each Agency. That profit or loss would be equal to the vouchers they receive from the States minus the amount of their actual budget.
8. In subsequent years the actual Budget allocation would be adjusted in the light of profit and loss. The adjustment could be automatic or it could be negotiated with the Treasury.
9. A separate fund would be set up for experimental programs. States would receive vouchers which they could then use to purchase experimental programs from whatever Federal Agencies they thought would be must effective.

5.6 Outline of a possible national decentralized PSD program

The following pilot program can be introduced to test contests between sub-national entities for federal matching funds. The first step is to recognize that in Mexico there is intensive competition between sub-national authorities in attracting investments. In effect, sub-nationals authorities compete with each other in provision of better investment environment. The second step is to recognize that existing competition has important limiting features in terms of its protagonists and instruments:

- It is limited to large shakers and movers: multinationals and domestic corporate groups. SMEs are often so far off in terms of their capabilities that they are not even perceived as strong agents capable of making a difference at the local level. .

- It is limited to the strongest sub-national entities. The investment environment of less developed states is so weak that they often have no motivation to woo investors by improving investment environment. To substitute for the weak investment environment, special favors like tax holidays are sought.

- The competition for investors often has a strong component of rent seeking. Less developed regions perceive that they are entitled to subsidies, tax holidays and other forms of preferential treatment to level the playing field between weak and throng sub-national entities. The problem is not subsidies per se but the fact they are allocated in a way that undermines incentives to engage in improvement of incentive environment.

From implicit contests to transparent competition between sub-national 'competitiveness projects'. Can one remedy the flaws mentioned above? Can one, broaden efforts in improvement of investment environment by motivating the less-developed states? Can one deepen the competition for investors by explicitly including SME- related programs? Can one make allocation of subsidies more transparent?

Imagine that each state with a motivation to improve investment environment presents a plan, a state-level competitiveness project outlining what kind program it would like to put together to address, for instance, the following issues:

- Deregulation and reduction of administrative costs for entry, doing business and exit
- Business development services for firms and facilitation of linkages between large firms and SMEs
- Enterprise training and university-industry linkages
- Reduction of logistics costs in supply chains

Initially one can start from one issue from this list. The idea is to have a two-prong competition to make strong and less-developed state compete in different leagues, with federal technical assistance available for less developed states to help them put together meaningful projects. As a demonstration of commitment, each proposal would secure some financing from sub-national governments and private sector. For instance, if the state governments propose a design center for shoe-making SMEs, it has to put their own funds and secure co-financing from private sector beneficiaries. The contest thus is a familiar bid for federal subsidies, except that sub-national competitiveness project are open-ended. The point of the contests is motivation for private-public creativity. The contest is an incentive device for private and public actors to come together to develop innovative solutions to improve the investment climate on a sub-national level: it is about waking up the social energy and creativity.

What are the criteria to determine winners and who are the judges?. Every contest requires rules, transparent criteria to determine winners and judges. One can think about two types of criteria:

- Credibility of the past efforts to improve the sub-national investment environment and competitiveness.
- Creativity of and commitment to state-level competitiveness proposal to improve investment environment.

A set of sub-national indicators has been developed to monitor sub-national business environment and state-level competitiveness. For instance, Monterrey Institute of Technology in Mexico monitors major state-level indicators of competitiveness (discussed in Chapter 2) on an annual basis. States putting more effort could see their progress with numbers and graphs and the benchmarking exercise did gain credibility among the government and private sector investors.

The second criteria, quality of the sub-national competitiveness proposal is, by definition, subjective. The credibility of the contest will be vested in Private-Public Advisory Council consisting of top private sector leaders and public sector managers with vision, standing and reputation for honesty. Reputation of the Advisory Council which will allocate federal subsidies to sub-national projects is one safeguard that discretion in allocation of public money will not lead to self-dealing. The second safeguard, is the matching grant principle. State government and private sector beneficiaries will have to demonstrate commitment by contributing their own resources, both in cash and in kind. The competition is for the size of the matching funds from the Federal level. The third safeguard is the stipulation that there will be no losers. Every state which have developed high- quality proposal and demonstrated commitments of private stakeholders will receive some federal contribution.

The contest achieves its objectives by providing motivation to sufficient number of states to participated and not so much by the amount of federal funds disbursed. To sum-up, the rationale for the contest, is three-fold:

- As an incentive device for sub-national government and private sector to engage in meaningful joint action and reform.
- As a coordination device to stimulate joint activities of federal government, sub-national governments and private sector beneficiaries under the umbrella of private-public competitiveness projects.

- As a mechanism to share policy knowledge. The idea is that innovative promising solutions emerging in one locality will quickly adopted in the other.

The implementation of this mechanism could take the form of Trust Fund (fideicomiso) financed by multilateral agencies and the Federal Government (see more in Annex 3). Access to the funds should include a bidding process designed in a way that cities belonging to the same clusters had an incentive to cooperate and present their proposals jointly. State governments could participate along with municipalities. In the case of clusters located in more that one State, participation of State administrations could be particularly appropriate. Each cluster should define the kind of investment and/or technical assistance, provided that the intervention is at the cluster level. Proposals including public-private partnerships should be encouraged.

Similar contests have been already put in practice in the World Bank' projects (Box 5.5).

Box 5.5 Contests for federal funds between sub-national governments: Lessons from the World Bank projects

Russia Fiscal Reform Loan: Regional Reform Fund.

In the project, resources from the Regional Reform Fund will be awarded on a competitive basis to pre-qualified regions that demonstrate improved fiscal performance and progress in implementing a program of regional fiscal reform. These programs have been elaborated with the help of the Regional Fiscal Technical Assistance Project. A detailed approach to measurement of progress has been developed by the Ministry of Finance in conjunction with the Bank. In the first tranche the Bank will agree on the basic operating procedures. Subsequent tranches will call for refinement of selection criteria and implementation of the Regional Reform Fund satisfactory to the Bank.

Ukraine Private Sector Development: Adaptable Lending Program

Ukraine Private Sector Development Adaptable Lending program envisions matching funds support to enterprise restructuring in oblasts (sub-national analogue of Argentinean provinces) which selected competitively. The contest between oblasts is based on their progress in monitorable indicators of regulatory environment. These indicators are measured bi-annually in all 26 oblasts through an enterprise survey. Every two years of the adaptable lending program, two new oblasts are added to the program and these are precisely the oblasts recorded the largest improvement in regulatory environment for business. A more controversial feature of the contest is exit criteria. The loan appraisal document envisions exit from the projects of the oblasts with the worst performance in terms of regulatory environment. It remains to be seen whether both the Bank and the Federal Government of Ukraine will be able to adhere to this strict exit criterion.

5.7 Role of the World Bank and Other International Organizations

Is there comparative advantage?

Institutional development takes time. Relevant World Bank projects (like supplier development initiatives) are design- and implementation- intensive. Does the IBRD have a comparative advantage in relation to IFC and grant-based activities of philanthropic foundations? If so, which is this comparative advantage? The report argues that grant-based support to small pilot projects, the World Bank interventions, and the IFC involvement are all have a role to play but on different stages of organizational evolution

Stages of organizational evolution and comparative advantages of donors

Private-public organizations – local economic development agency in Aguas Calientes, supplier development agencies in Jalisco and Chihuahua and other organizations discussed in the Report --appear to evolve in through the following stages:

- Organization as a group of champions (*embryonic stage*) involved in experimentation and piloting of appropriate organizational model. This is the stage which warrants grant support of philanthropic foundations and UNDP. Supplier development intitiaves of UNDP is an example of the best practice.
- Private-public organization demonstrates results and gains credibility, yet it may still need some public support to generate demand and enhance supply of its services (*infant stage* of organizational development). At this stage the IBRD can provide the most value added through its knowledge-sharing role.
- The private-public organization has generated sufficient client base to support itself commercially. This is the stage of the IFC involvement.

In this approach the World Bank helps *to graduate* bottom-up initiatives supported by grants (Inter-American Foundation, UNDP, Multi-lateral Investment Fund of the IDB) into the commercial market place supported by the IFC. An example of such approach is Zacatecas supplier development imitative to be supported by joint IFC-World Bank SME Department, which is currently under preparation. It builds on a diversity of grant-based efforts of UNDP, and has an explicit intention to develop the initiative into a commercially sustainable IFC project.

Bottom-up approach to donor coordination

In this example, coordination between grant-making donors (UNDP), IBRD and the IFC is occurring in a bottom-up fashion and through active involvement of state government. The state governments assures grant support to creative group of private and public champions, then brings the Ibis, and as relevant organizations matures and develops a knowledge base, it becomes ready for IFC support on a purely commercial basis.

Following the three-prong approach decentralization of industrial promotion (state-level initiatives; federal facilitation and monitoring of regional initiatives; national framework shared change agenda), the World Bank has three roles to play:

- Support to state-level pilot initiatives: regional LILs
- Support to scale-up regional experiment and to federal system of facilitation and monitoring: possible Competitiveness Adaptable Program Lending
- Support to the national framework of shared vision-building: non-lending services – the World Bank as a knowledge broker

In a nutshell, the World Bank and other international organizations can act as impartial knowledge brokers to help Mexican government to refine the proposed ideas to make them more relevant to specific Mexican localities and to test them over a two- to three-year period in three or four selected regions/States. It remains an open question whether it is preferable, given the recommendation of restricting an initial demonstration project to a small number of regions, to attempt to test the ideas across the broad range of support services to non-financial enterprises, or whether it may be preferable to restrict initial testing to a subset of problem areas, such as supplier development or improvement o business environment discussed above, or even further limit the testing to a specified set of industries. It is suggested that geographic areas chosen have a very energetic individual or set of local champions who understand and agree with the underlying logic of the scheme, and who would therefore be strong promoters of the concepts.

Table 5.3 summarizes the proposed three-pronged view of the World Bank interventions

Table 5.3 World Bank Support: Three-prong Approach

	Activities completed, dropped or under preparation	Proposed activities
1. Support to State-level initiatives (entry points)	Regional PSD Yucatan LIL (with Nafin) Border Infrastructure LIL (with SEMARNAP), dropped) Mexico City micro-business pilot Centro Mexicano de agronegocios IDF (with Sagar) IFC-World Bank Zacatecas Supplier Developemnt Initiative	Supplier Development LIL (Jalisco, Chihuahua, Aguas Calientes)
2. Federal system of facilitation and evaluation	Competitiveness Enhancement project with SECOFI (dropped) Remittances for SMME and infrastructure development (NAFIN) Decentralization of Industrial Promotion ESW (SECOFI, NAFIN)	Competitiveness enhancement APL Seminar on Decentralization of Industrial Promotion
3. Knowledge broker for the national shared vision and change agenda Mexico 2025	Mexico 2020 series of seminars with ITESM (Monterrey, 1998, Mexico City, 1998, Mexico City, 1999, 2000, Campeche 2000);	Mexico 2025 series of regional seminars with ITESM as part of preparation Competitiveness APL and financed by PHRD grant

In terms of concrete practical steps, the transformation to a new incentive framework for industrial promotion may involve the following five steps:

- Design of the new system (role of stakeholders, internal consistency etc.)
- A strategy to introduce the new system by matching new roles to capabilities

- Preparation of pilot promotion projects on sub-national levels
- Implementation and monitoring of pilot projects
- Mainstreaming of the decentralized demand-driven approach to all States

Each of these steps fits well into World Bank project cycle. Table 5.4 summarizes the preparatory activities and the possible World Bank role.

Table 5.4 Project Cycle of Programs and the World Bank Projects

	Role of local private-public partnerships	Role of Federal government	Proposed World Bank product	Relation to the new Bank's project cycle 'Listening' – 'Piloting' – 'Learning' – 'Monitoring'
Preparatory phase I **Design** *of decentralized demand-driven system*	Participation in the design of the new system	Leading role: design of a consistent system	**Knowledge sharing: best-practice seminar** 'Regional Development and Decentralization'	*Listening* – helping the stakeholders (local private-public partnerships, federal government) articulate demand and institutional configurations of new projects
Preparatory phase II **Matching roles to capability:** *Assessment of private-public partnerships in selected States*	'Where we are and what to do next?' -- self-assessment of sub-national comparative advantage and capability for collective action	Elaboration of methodology for the self-assessment of private-public partnerships	**Assessment of private-public partnerships:** Evaluation of the capability of local stakeholders to design and implement decentralized programs	*Listening* – assessing implementation capabilities
Preparation of **pilot projects** (LILs) in selected States	Leading role Preparation of the projects as the outcome of sub-national self-assessment	Assistance with the design of State-level projects	**Private Sector Development LILs** in selected States	*Piloting* – testing new institutional arrangements
Implementation and monitoring of pilot projects in selected States	Provision of information	Leading role. Design of the methodology. Learning from mistakes and successes	**Monitoring and benchmarking methodology** for local private-public initiatives and LILs	*Monitoring* – learning from successes and failures
Mainstreaming of the decentralized approach to all States	Readiness to share local successes and failures	Knowledge sharing: dissemination and best-practice fora	**Adaptable lending program** for private sector development	*Mainstreaming* – scaling-up of the pilot projects to national level

Annex 1 Deregulation and Improvement of Business Environment: State-Level Dimension

A1. Mexico's Deregulation Czar

In 1988 the President of Mexico appointed a "deregulation czar", who , each month, reported directly to the President and his Economic Council of Ministers. Every business in Mexico, large or small, had equal access to the czar's office to complain about burden-some rules and regulations. When the office received a complaint, it was obliged to find out why the rule existed, how it interacted with other regulations, and whether it should continue in effect. The office operated under a strict timetable. If it did not act to maintain, revise, or abolish the disputed rule within forty-five days, the rule was annulled automatically.

The work of the deregulation czar over his first four years was widely credited for greatly accelerating Mexico's reforms. It provided struggling private business-people with an effective, responsive champion at the highest level of government. The factors behind this success included unequivocal presidential support, signaling to both bureaucrats and citizens the need to comply with the czar's decisions.

Since the Miguel de la Madrid administration, deregulation was considered a top priority in the National Development Plan, but major efforts were realized during the administration of Carlos Salinas de Gortari and promoted later by the Zedillo Administration. In 1995 the Acuerdo para la Desregulación de la Actividad Empresarial (ADAE) was signed, to simplify the number of proceedings and length of time to start a new business. Measures were adopted to deregulate road transport, rail freight, air transport, ports, highways, telecommunications, and electric power.
Chart A1.1 shows how deregulation can take place. If it affects minor laws it could be carried out through decrees and administrative procedures. These types of decrees would affect mainly procedures that have been bureaucratized, i.e., enterprise registry, where everybody was willing to intervene to have an extra income. Deregulation may also require Constitutional reforms, as in the case of landownership, banking,

telecommunications and petrochemical, as would be in the case with utilities (article 27 of the Constitution). Amendments to the Constitution must be approved by the Congress.

Chart A1.1 Evolution of deregulation

Constitution / Strategic areas

- Telecommunications → Reformed
- Land property → Reformed
- Basic infrastructure ports, highways, air transport, rail freight → Reformed
- Natural Resources i.e. oil, gas, water, electric power
- Bank system → Reformi

Congress dis

Institutions

- Ley Federal de Competencia Económica
- Comisión Federal de Competencia
- Unidad de Desregulación

Decrees to De-bureaucratized Federal and State System

- Administrative simplification
- Number of procedures and time to open a new business
- **Deregulation process:** Transporte de carga, transporte multimodal, líneas áreas nacionales, auto transporte turístico, transporte de pasajeros, ferrocarriles, maniobras en zonas federales terrestres, maniobras en zonas portuarias, servicios portuarios, uso de equipo de telecomunicaciones, telecomunicaciones, ley federal de puertos, ley federal de caminos, puentes y auto transporte, ley de navegación, industria salinera, cerillos, energía eléctrica, ley del servicio público de energía eléctrica y su reglamento, reglamento de distribución de gas licuado de petróleo. Comercio de azúcar y cacao, control de transferenci de tecnología y uso de patentes y marcas, promociones y ofertas, agente aduanales, industria del maíz, eliminación del control de cambios, ley general de sociedades mercantiles, control sanitario de la publicidad, ley federal de turismo, ley de cinematografía, ley federal de protección al consumidor, ley federal y reglamento de la correduría pública, regulació de la industria de la azúcar, ley de la industria del henequén, del cacao, del café, reformas al artículo 27, ley federal de sanidad animal, ley federal de sanidad vegetal, asuntos migratorios, pesca, regulación sanitaria, uso de zonas federales marítimo terrestres, ley federal de metrología y normalización, ley federal de aguas.

to all public officials.

The Supreme Court could only participate if there is any Constitutional amendment that requires clearing up.. In recent years the Supreme Court has participated in the telecommunications privatization (basically Telmex), and in 1989 with the reform of the Foreign Investment Law which required Congress approval and was authorized temporarily by a Presidential decree in 1989, obtaining Congress approval in 1993 with Nafta regulations.

Given the time limit, which ensured quick and visible results the czar's staff, were skilled in bearing the economic consequences of regulations, their interactions with other regulations, and their administrative requirements, while effectively carrying out this government wide program of deregulation. They won much credibility with officials and with the public by giving a fair hearing to the powerless and the influential alike, and setting a consistent record of impartiality.

The Czar of deregulation at the time ,Mr. Rogozinski, housed by Secretaría de Hacienda, held all the power to promote reforms. Staff was quite small and relied on duties around the Hacienda network which allowed them to have a very flexible scheme. The two main offices the one that undertook the tasks were, Hacienda and Secofi. Administrative procedures reforms were carried out by Secofi, and main tasks undertaken by Hacienda. The power of the two Ministeries helped the government to carry a large deregulation program.

A.2. Benchmarking Regulatory Enviroment[1]

Ensuring regulatory transparency

- A standardized procedure to create regulatory standards was established by law in 1992. Since then, standard-setting has involved a "notice and comment", detailed consultation, and cost-benefit analysis.
- Although there are no government-wide public consultation procedures, a Federal Administrative Procedure Law that came into effect in 1994 enhanced regulatory transparency and accountability.

[1] Regulatory Reform in México, OECD, Reviews of Regulatory Reform, 1999

- An official registry of all business formalities is published on-line on the Internet (http://www.cde.gob.mx).

Promoting regulatory reform

- Since 1989, reform policies have been established directly by the President on the basis of presidential decree. The current program– Acuerdo para la Desregulación Empresarial (ADAE) -, establishes a regulatory management system based on central oversight by a co-ordination unit – Unidad de Desregulación Económica (UDE), which today is Consejo Nacional de Desregulación (CND) -, under the responsibility of the Ministry of Trade and Industry
- The ADAE establishes a high level Economic Deregulation Council where business and governmental representatives, oversee the progress.
- The UDE coordinates and monitors the regulatory reform programs of the 31 federal states.

Adopting explicit standards for regulatory quality

- The current policy requires that draft laws and subordinate regulations justify the government action, that potential benefits justify costs, that impacts on SMEs are minimized, that regulatory objectives cannot be achieved through better instruments, and that implementation is backed by sufficient budgetary and administrative resources. The reviews of business formalities use the same criteria.

Reviewing and updating regulations

- In the past 15 years, 90% of existing federal laws have been reviewed, eliminated or modified to support a market economy and improve transparency and consumer protection.

Assessing regulatory impacts

- In 1996, the Administrative Procedure was amended to require regulatory impact analysis (manifestación de impacto regulatorio) for all new draft laws and subordinate regulations with possible impacts on business. The ministries carry out the analysis, and the UDE and the Economic Deregulation Council assure quality.

Reducing administrative burdens

- As part of the ADAE, a complete review of existing formalities was launched by the administration. By July 1999, 10 out of 12 agencies of the government had pledged to eliminate around 50% of mandatory formalities, simplify and improve 97% of remaining formalities. The inventory, set up in 1996 and accessible through Internet, is being transformed into an official registry to provide legal security to business – only registered formalities can be enforced – and serve as an electronic one-stop shop.

A.3. Deregulation at the State level: Example of Jalisco

One of the most successful stories has been the Jalisco case, where reengineering has allowed to lower the number of days to a minimum of 11 and a maximum of 96, an average 38.9 days for getting a working permit on non contaminating activities. The main aim of the program is to reinvent the organization, not only improve the actual program; for that purpose total quality method is being followed to satisfy businesses needs in terms of time, quality, service and cost. The most important problems to solve were: procedure simplifications, get more and better information, organize, train and improve collaboration within the people attending regulation procedures. The Jalisco government was able to identify Best Practices of the process, to get into specifics projects and to improve in an important level the institution efficiency. Chart A1.2 shows the stages followed by Jalisco government to get into a reengineering of the decentralization process.

Chart A1.2. JALISCO: DEREGULATION REENGINEERING PROGRAM

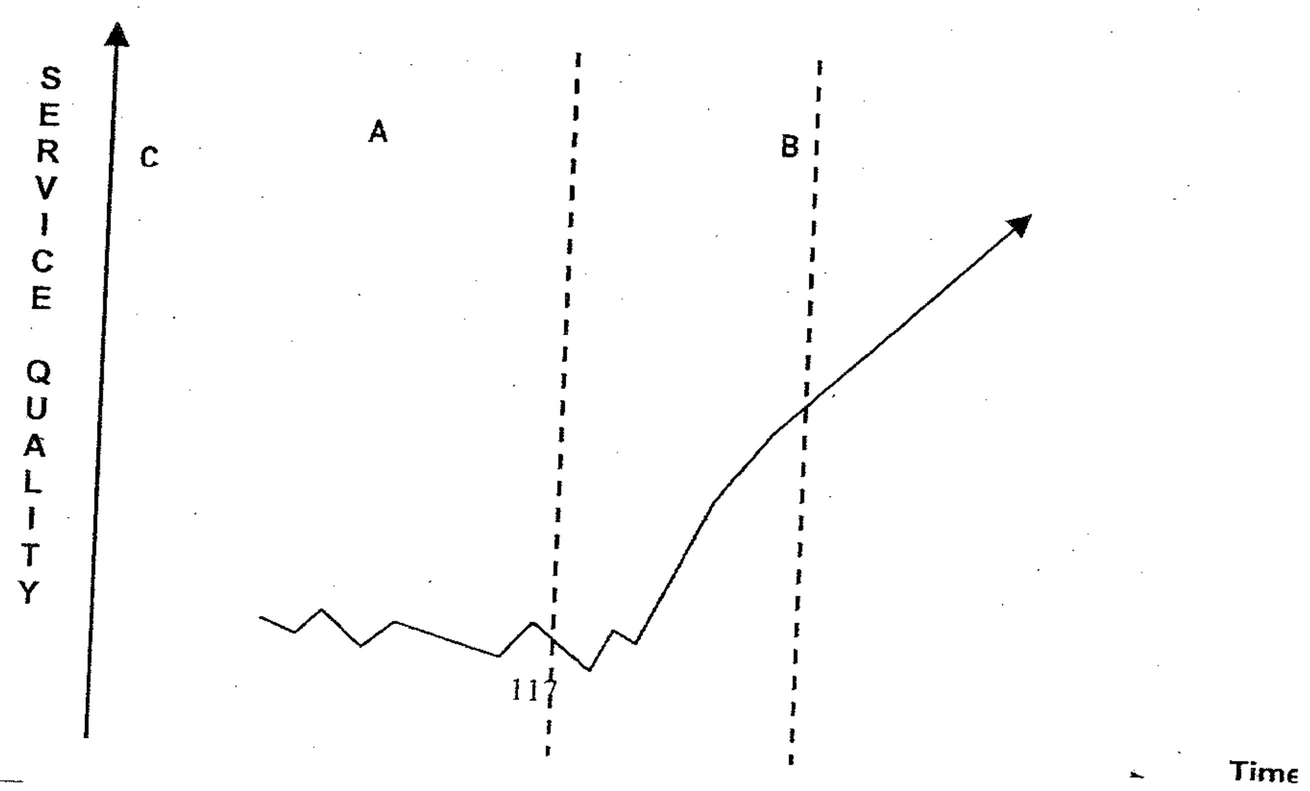

Chart A1.3 **Reengineering of Deregulation**

What is the process radical redesign?

" Is to reinvent the organization and its process, not only improving the actual shape"

Desired State of the Process
Focused to satisfied the citizen needs on:
Time
Quality
Service and Cost

Deregulation Improvement

Actual state of the process:

- Does it respond to the citizen needs?
- Is good the time to get an answer ?
- It's cost is optimum ?
- Does the service has a quality level ?
- Does it eliminate waist?
- Is trustable and stable?

HIGHLY IMPORTANT

- **PROCEDURE SIMPLIFICATION**
- **MORE AND BETTER INFORMATION**
- **SIMPLIFICATION**
- **ORGANIZATION AND COOPERATION BETWEEN THE INSTITUTION PERSONAL**

VERY IMPORTANT

- **TRAINING**
- **INFORMATION MODUL**
- **KIND TREAT**

IMPORTANT

- **MOBILIARY**
- **IMPROVE THE DECORATION, VENTILATION AND ILUMINATION INSIDE THE OFFICE**

In April, 1998 a minimum of 11 days and a maximum of 96, an average 38.9 days for new licenses on White activities

On controlled activities a minimum time of 18 days and a maximum of 164, an average 67 days to get a new license

Annex 2 Inventory of Federal and State PSD Programs

Mexico's traditional system of promoting industrial development was based on a centralized model (CIP) which the federal government used to provide support services and financial assistance. Local agencies played a marginal role in the promotion of industrial development. The Central government became active in the late 1940's and early 1950's by offering basic fiscal and financial incentives, non-discrimination policies among producers, and by not defining specific goals for the producers. When import substitution policies collapsed in the 1980's, the federal government moved toward a more horizontal type of support—where non-financial services became the basic source of support— expanding the number of agents involved and also the policy tools needed for implementation. A summary of how federal policies have evolved over time is shown in Table A2.1

Table A2 .1 Industrial Policies in Mexico

	Stage 1	Stage 2	Stage 3
Policy	Vertical industrial policy	Transition Model	Horizontal industrial policy
Tools	Sector selection, tax rebates and subsidized interest rates.	Disappearance of sector guidance and subsidies, with substitution for training and access to credit policies.	Benchmarking, information exchange, training, clustering, and networking and financial guarantees policies.
Institutions	Central government institutions and Development Banking	Central government institutions and Development Banking	State, local, central government and Development Banking

With the introduction of horizontal policies and the demise of a promotion budget at the Federal level, a new promotion model has emerged at the State level. This was not a planned process of traditional decentralization, but rather a heterogeneous process where some regions have been able to set a new promotion mechanism (based on their own resources) with the support of decentralized programs of the federal government. These programs include the Committee for productivity and technological innovation (Compite), the Regional Centers for Entrepreneurial Competitiveness (Cetro-Crece), and the Export Promotion Mixed Commission (Compex). State governments have institutionalized their own system of promotion which is coordinated through a local office. In most cases the States ranked it as a Secretary, for example, Secretaria de Promoción Económica.

Promotion entities are dissimilar in each state, some of them are well organized and work efficiently while others are bureaucratized, have very small budgets and couldn't develop their own tools of implementation. Local forces have organized themselves to react to the collapse of federal government support, causing the creation of new institutions. For analytical purposes, institutions can be grouped under the following headings:

- Public sector supporting institutions at state level.
- Private sector supporting institutions at state level.
- Educational supporting institutions at state level.

One of the main problems of these programs is that in many cases state policies are not coordinated with those enacted at the federal level, thus reducing the multiplier effect of the programs and its effectiveness. This also creates some duplication of promotion schemes. Having the advantage of being near their economic agents, some states have been able develop their own institutional innovations. There are two levels of support, the first is for general programs and the second for specific programs. What is important in this case is the existence of not only public programs, but also programs for private and higher education that create an environment fostering manufacturing and promoting dialogue among producers. Re-industrialization states - where dialogue has been more intense - have promoted interaction among agents, thus creating a virtuous circle for manufacturing promotion.

Table A2.2 State Promotion Policies and Deregulation				
Regions	Programs			Effectiveness of deregulation programs: days to open a new enterprise (Average)
	Public programs	Private programs	Higher education programs	
	(a)	(b)	(c)	(d)
Border States	7	9	9	71
Industrial restructuring	10	8	9	75
Mexico City and environs	4	2	7	96
South	1	1	1	64
Oil states	1	1	0	68
Tourism States	0	4	3	57
Raw Materials States	11	1	1.5	54

Source: Consejo Coordinador Empresarial, Comparative study of the regulatory quality on Mexican States, 1999 (2) Ruiz Durán Clemente, Micro enterprises support infrastructure, 1998

Some states have created an Economic Promotion Authority whose responsibility is to create a positive environment for investment within the state[1]. The Authority is deemed successful when it has developed dialogue among producers and set up rules that facilitate the opening of businesses. Deregulation has been successful in all regions when they have been able to reduce the amount of time needed to open a business compared with Mexico City and its environs. States have explored a more active policy, not just coordinating private dialogues, but also in developing new tools to cope with lags in the region. Most of them have been able to set up a financial network that supports small businesses. The more advanced states, such as Chihuahua and Jalisco, have been able to develop a program for supporting industries in their regions. Some of the regions have based their promotion on old tools that in this new environment had been successful as is the case of industrial parks in Queretaro, where more than ten industrial parks have been developed in the last decade. All of these best-case scenarios as described have created an environment for public sector innovation at the institutional level.

Table A2. 3 Public Sector Best Practices at State Level

	Secretaria de Promoción Económica	Deregulation Office	Public SME Programs		Secretaría de Promoción Económica	Deregulation Office	Public SME Programs
Aguascalientes	X	x	X	Morelos		x	

[1] The Economic Promotion Authority is more organized than traditional planning or development agencies that are more window oriented. In this case promotion is demand driven.

Baja California	X	x	X	Nayarit		x	
Baja California Sur		x		Nuevo León	x	x	x
Campeche	X	x		Oaxaca		x	x
Coahuila				Puebla		x	
Colima		x	X	Querétaro	x	x	x
Chiapas		x		Quintana Roo			
Chihuahua		x	X	San Luis Potosí			
Distrito Federal			X	Sinaloa		x	x
Durango			X	Sonora		x	
Estado de México		x	X	Tabasco		x	
Guanajuato	x	x	X	Tamaulipas		x	
Guerrero				Tlaxcala		x	
Hidalgo		x		Veracruz		x	
Jalisco	x	x	X	Yucatán			
Michoacán		x	X	Zacatecas			

Source: (1) Own elaboration with internet information. (2) Consejo Coordinador Empresarial, March 2000 (3) Ruiz Durán, Clemente, SME´s inventory, NAFIN, 1998

The greatest success of public policies at the state level has been the enhancement of private dialogue that was absent during the era of central government promotion. This dialogue has helped develop programs that promote industrialization in each region, which in turn created a reinforcing process in the public/private arena. Programs tend to different market niches, such as that of training or support services for business development. In fact, consulting firms have had a large growth in the country, so much so that a certification program is required to develop standards in this field. In some regions the private sector has developed more ambitious programs, the basic aim of which has been to promote an integrated industrial development. The most successful case has been Chihuahua, where the private sector (through "Desarrollo Económico de Chihuahua" in the 1990's) set up the successful program "Chihuahua Siglo XXI", and exporting it to other regions (such as Campeche) that have established a program to promote entrepreneurship "Transformando Campeche". In other cases, business associations had been the key factor in connecting these common efforts, as is the case of the Centers for Supplier Development in Jalisco and Chihuahua.

Table A2. 4 Private and Academic Best Practices at State Level

	Private SME Programs (1)	Academic SME programs (2)		Private SME Programs (1)	Academic SME programs (2)
Aguascalientes	X	x	Morelos		x
Baja California	X		Nayarit		
Baja California Sur	X	x	Nuevo León	x	x
Campeche	X		Oaxaca		
Coahuila			Puebla		x
Colima			Querétaro	x	x
Chiapas			Quintana Roo		
Chihuahua	X	x	San Luis Potosí		x
Distrito Federal	X	x	Sinaloa	x	x
Durango		x	Sonora		
Estado de México			Tabasco		
Guanajuato	X	x	Tamaulipas	x	x
Guerrero	X	x	Tlaxcala		
Hidalgo	X	x	Veracruz		
Jalisco	X	x	Yucatán	x	x
Michoacán			Zacatecas	x	

Source: (1) Own elaboration with internet information. (2) Consejo Coordinador Empresarial, March 2000 (3) Ruiz Durán, Clemente, SME´s inventory, NAFIN, 1998

Human capital development has been a key issue. Today, Mexico has a large educational network at the state level that has helped to promote linkage between industry and educational centers, revalue research, training, and technology transfer centers to name a few. States had been able to develop their own base of institutions – public universities and technological institutes– that have been helped by central government training programs the most important of which are Conalep, DEGETIS of the Ministry of Education, CIMO of the Labor Ministry, Educational Centers of SEP-Conacyt, and research programs of both the Instituto Politécnico Nacional and the National Autonomous University of Mexico. This entire network of institutions has helped develop entreprenuership.

Table A2. 5 States with educational programs to enhance entreprenuership.

Aguascalientes	Universidad Autónoma de Aguascalientes: carrera de técnico superior en administración de micro, pequeñas y medianas empresas.
Baja California Sur	Centro de Investigaciones Biológicas del Noroeste, de SEP-Conacyt.: Programa de Vinculación y Gestión Tecnológica. Incubadora de empresas de base tecnológica
Chihuahua	Universidad Autónoma de Chihuahua, Universidad Autónoma de Cd,. Juárez.: Centro de para el Desarrollo de Negocios Pequeños Instituto de formación de emprendedores de Empresas Familiares.

Distrito Federal	IPN, UNAM, ITESM, ITAM :Programas de apoyo a las MIPYMES, Programa Emprendedores, Centros de Competitividad.
Durango	Universidad Juárez del Estado de Durango Centro de desarrollo empresarial
Guanajuato	Universidad de Guanajuato: Centro de Negocios e Incubación Tecnológica. SEP-DEGETIS: Programa de Creación de Micro empresa
Guerrero	Universidad Americana de Acapulco: Centro de Desarrollo Empresarial.
Hidalgo	Universidad Autónoma de Hidalgo: Programa de Capacitación Empresarial
Jalisco	ITESO, Universidad Autónoma de Guadalajara, Universidad de Guadalajara: Centros de Vinculación y Programa de Clínicas Empresariales.
Morelos	Instituto Nacional de Investigaciones Eléctricas ITESM: Incubadora de Empresas de Base Tecnológica.
Nuevo León	Universidad Autónoma de Nuevo León, ITESM, Centro de Apoyo Integral a la Micro y Pequeña Empresa (CAIMPE), Instituto de Calidad y Modernización de CANACO.
Puebla	Universidad Benemérita de Puebla: Programa de Clínicas Empresariales
Querétaro	Centro de Investigación y Asistencia Técnica del Estado de Querétaro (CIATEQ) SEP-Conacyt Centro de Ingeniería y Desarrollo Industrial (CIDESI), SEP-Conacyt
San Luis Potosí	Centro de Desarrollo Empresarial: programa de vinculación con el sector productivo
Sinaloa	Centro de Ciencias de Sinaloa: Centro de servicios de capacitación e investigación Universidad de Occidente: Centro de Asesoría en Negocios Internacionales
Sonora	Universidad de Sonora, Centros de Consultoría ITESM: Clínicas Empresariales.
Tamaulipas	Instituto Tamaulipeco para la Elevación de la Calidad
Yucatán	Centro de Capacitación y Desarrollo Empresarial Integral

El esquema que se propone puede aplicarse a un nuevo paquete de estímulos a la pequeña y mediana empresa o bien a un paquete conformado con los estímulos actuales, reunidos bajo un solo Programa. En este último caso, deberán revisarse los ordenamientos existentes en la materia y las responsabilidades de las distintas dependencias federales que actualmente controlan diversos instrumentos. El esquema toma elementos de varios mecanismos existentes, principalmente de Alianza para el Campo. Forman parte del esquema los siguientes elementos:

A. El **Convenio** para la Descentralización de la Promoción Económica, que se firma entre la Federación y los gobiernos de cada uno de los estados.
B. El **Consejo** Estatal para la Promoción Económica, en cada una de las entidades federativas.
C. El **Consejo Consultivo** Nacional para la Promoción Económica.
D. La **Estrategia** de Desarrollo Económico de cada entidad federativa.
E. El **Programa** de Promoción Económica de cada estado.
F. El **Fideicomiso** de Administración e Inversión de los Recursos del Programa de Promoción Económica, en cada estado.
G. El **Comité** Técnico del Fideicomiso, también en cada estado.
H. Las **Reglas** de operación del Programa de Promoción Económica.
I. Las **Unidades Ejecutoras** de los diversos programas de promoción económica.
J. La **Comisión** de Evaluación del Programa, en cada estado.
K. La **Comisión Nacional** de Evaluación
L. El **Presupuesto** de Egresos de la Federación y los **Presupuestos** de Egresos de cada estado.

A continuación se describe cada uno de los anteriores elementos y al final se hacen algunos comentarios adicionales sobre la operación del esquema en su conjunto.

A. Convenio. Este es el elemento más importante del esquema. Lo firman, por un lado, el Secretario de SECOFI y, por otro, cada Gobernador. En él se fijan los compromisos de la Federación y de cada estado en cuanto al funcionamiento del esquema. Aquí es donde se tienen que incorporar los criterios de selectividad y las reglas de puntuación, que constituyen los ejes básicos de la propuesta.

Mediante el Convenio, la Federación y los estados se comprometen a hacer aportaciones iniciales para el Programa. La contribución de la Federación será en principio equivalente a la que cada estado aporte, pero podrá aumentar en función de otros parámetros concretos que los estados cumplan y que serán calificados:

1. La aportación del sector privado (0 a 20 puntos). Esta aportación puede ser en efectivo o en especie, por ejemplo, en oficinas para la operación de ventanillas de atención los usuarios del Programa, en personal, en publicidad, etc.
2. La evaluación que se haga del Programa de cada estado (0 a 20 puntos).
3. Los incrementos de la producción y el empleo logrados con el Programa estatal(0 a 20 puntos).
4. Los incrementos de las exportaciones logrados con el Programa estatal (0 a 20 puntos).
5. El aumento del contenido nacional de la producción logrado con el Programa estatal (0 a 20 puntos).

De acuerdo con los puntos anteriores, la calificación máxima es de 100 puntos: La aportación federal aumentaría un punto porcentual por cada punto de calificación.

En el Convenio también se acuerdan los siguientes puntos:

- Ejercer los recursos del Programa a través de un Fideicomiso de Distribución de Fondos, incluyéndose los que eventualmente aporte en efectivo el sector privado de cada estado y los productores o sus organizaciones. El Fideicomiso será de carácter privado.

- Los compromisos que asume cada nivel de gobierno en la coordinación de actividades para la ejecución del Programa.
- Los principales componentes e instrumentos del programa.
- Destinar el 3% de las aportaciones totales que reciba el Fideicomiso a la evaluación del Programa.

B. El Consejo Estatal para la Promoción Económica se encargará de integrar la Estrategia y el

Programa de cada estado y le dará seguimiento a su instrumentación y resultados, así como a las acciones y compromisos que se prevén en el Convenio.
El Consejo Estatal tendrá participación de los representantes de las organizaciones empresariales de cada entidad federativa, así como de las Universidades, Institutos de Investigación y Colegios de Profesionales del estado ligados con los sectores productivos más importantes para la Estrategia y el Programa.

Estará presidido por el Gobernador del Estado, con un representante de la SECOFI como secretario técnico.

C. El Consejo Consultivo Nacional se encargará de evaluar las Estrategias y Programas de cada Estado y de proponerle al Secretario de SECOFI las calificaciones de los diferentes factores considerados en el Convenio, en cada caso.

El Consejo Consultivo tendrá participación de los representantes de las organizaciones empresariales a nivel nacional, así como de las Universidades, Institutos de Investigación y Colegios de Profesionales del país ligados con los sectores productivos más importantes para la Estrategia y el Programa.

Estará presidido por el Secretario de SECOFI, con el Subsecretario del ramo como secretario técnico.

D. La Estrategia de Desarrollo Económico de cada Entidad Federativa es el documento en donde se describen los escenarios de carácter económico y social a que aspiran los sectores de la sociedad local a diversos plazos, los retos y oportunidades derivados de dichos escenarios y las principales vertientes sectoriales y regionales para lograrlos.

La Estrategia será integrada por el Consejo Estatal a través de una consulta promovida por el Gobernador entre los diferentes sectores económicos del estado.

E. El Programa será elaborado por el mismo Consejo a partir de la Estrategia y especificará metas concretas a alcanzar a corto y mediano plazo a través de los distintos componentes e instrumentos disponibles. También será sometido a consulta, en reuniones de trabajo de carácter técnico.

F. Fideicomiso de Distribución de Fondos. Este Fideicomiso se crea en cumplimiento del Convenio y tiene las siguientes características:

- Participan NAFIN como fiduciario, el gobierno del estado como fideicomitente y los beneficiarios del Programa como fideicomisarios.
- El Fideicomiso no tiene personal ni estructura administrativa. Opera a través de las dependencias y entidades que se especifican en las Reglas de Operación del Programa. Las más importantes son las Delegaciones de SECOFI, las delegaciones de NAFIN y las oficinas estatales responsables que designe el gobierno estatal (normalmente una Secretaría de Promoción Económica).
- Los recursos aportados al Programa por los gobiernos federal y el estatal se ejercen incorporándolos al patrimonio del Fideicomiso.
- Los recursos federales que aporte la SECOFI se entenderán como subsidios y transferencias, por lo que deberán cumplir con las disposiciones presupuestales correspondientes.
- El fiduciario, en cumplimiento de los acuerdos del Comité Técnico del Fideicomiso, va liberando los recursos a los proyectos aprobados por dicho Ccomité, a través de las ventanillas operativas. La única obligación del fiduciario al efectuar el pago es recabar el recibo correspondiente.

G. Comité Técnico del Fideicomiso. Este Comité tendrá las siguientes características:

- Está presidido por el Gobernador del estado y compuesto por un vicepresidente, que deberá ser responsable de alguna de las Unidades Ejecutoras, dos representantes del gobierno del estado, dos de la SECOFI, dos de las organizaciones empresariales del estado y dos de las instituciones académicas u organizaciones civiles relacionadas con la problemática de los sectores económicos del estado, así como un representante del Fiduciario, que tendrá voz pero no voto.
- Podrá invitar a sus sesiones a las asociaciones de productores y organizaciones sociales cuyas actividades tengan relación con las funciones del Fideicomiso.
- Se reunirá cuando menos cada 2 meses y sus sesiones serán válidas cuando acuda el 50% más 1 de sus miembros.
- Dará por escrito sus instrucciones al Fiduciario para que entregue a los Fideicomisarios los recursos en numerario que el mismo Comité Técnico determine como apoyos.
- Determinará las modalidades específicas de operación del Programa a nivel local. Para esta función, así como para el dictamen de las solicitudes de los productores, el Comité Técnico podrá apoyarse en Subcomités Técnicos Operativos.
- Opinará sobre las reglas que se propongan para la evaluación del Programa y liberará oportunamente los recursos para dicha evaluación.
- Aprueba la organización de las tareas locales para la instrumentación, supervisión y evaluación del Programa.

H. Reglas de Operación del Programa. Éstas serán emitidas por SECOFI en el Diario Oficial de la Federación y regirán el ejercicio de los recursos aportados por la Federación y aprobados en el Presupuesto de Egresos de la misma. En ellas se especifican los objetivos del programa, los requisitos que deben reunir los solicitantes de los apoyos, las reglas de elegibilidad para el otorgamiento de dichos apoyos, el monto máximo de los mismos y las modalidades bajo las cuales se otorgarán.

I. Unidades Ejecutoras del Programa. Serán las Delegaciones de SECOFI, de NAFIN, y las oficinas estatales habilitadas para el efecto por los gobiernos del estado. Estarán a cargo del funcionamiento de las ventanillas de atención a los beneficiarios y como entidades operativas ejecutoras se encargarán de:

- Recibir las solicitudes por parte de los posibles beneficiarios.
- Preparar los expedientes técnicos y someterlos al Comité Técnico del Fideicomiso.
- Instrumentar las decisiones del Comité sobre la aplicación de los recursos del Programa.
- Vigilar que se cumplan los compromisos de aportación y de organización de los beneficiarios, así como todos los demás requisitos que estipulen las Reglas de Operación.

J. Comisión de Evaluación del Programa. Se encargará de coordinar las tareas de evaluación en cada entidad federativa. Un 3% de los recursos totales del Fideicomiso se aplica a las tareas de evaluación. Éstas deberán ajustarse a las reglas generales que estipule el Convenio y a la metodología que se proponga por parte de la Comisión Nacional de Evaluación, a solicitud de SECOFI. Las tareas de evaluación se realizarán al final de cada ejercicio presupuestal. Para llevarlas a cabo se contratará a despachos externos.

K. Comisión Nacional de Evaluación. Se encargará de proponer al Secretario de la SECOFI las reglas y la metodología para las tareas de evaluación , cuidando de que, entre otros propósitos, sirvan para la estimación de los diversos parámetros de calificación señalados en los Convenios.

L. Presupuesto de Egresos de la Federación y Presupuestos de Egresos de los Estados. En ellos se aprueban los recursos anuales de carácter federal y estatal que se aplicarán al Programa durante el ejercicio. Deberá procurarse que el manejo de las partidas presupuestales y su control se adapten a las necesidades de flexibilidad de los Programas estatales. Asimismo, para mayor certidumbre de los beneficiarios, se impulsará la elaboración de presupuestos multianuales.

Annex 4 Factores de éxito de las PyMes mexicanas

Encuesta

Objetivos:

- Ubicar a las empresas micro y pequeñas que han operado de manera exitosa y determinar la importancia que han jugado los actores e instituciones públicas y privadas sobre el desempeño de estas empresas, particularmente en los procesos de exportación y subcontratación entre otros
- Evaluar los programas locales y regionales de fomento y promoción, y su incidencia en el desarrollo de las micro y pequeñas empresas

A. Características de la empresa

1. Año de establecimiento ______________

2. Evolución de las ventas en los últimos tres años

Año	Ventas	Variación %
1996		
1997		
1998		

3. ¿Cuál es el nivel de sus ventas en el mercado nacional y para exportación?

Año	Nacionales	Exportación
1996		
1997		
1998		

4. ¿Cuáles fueron las razones por las que ubicó la empresa en esta ciudad?

B. Perfil del empresario exitoso

5. Edad del empresario

Menos de 20	
21 a 35	
36 a 45	
46 a 55	
De 56 o más	

6. Lugar de nacimiento

Ciudad	
Área Rural	
Extranjero	

7. Ocupación del padre

Obrero	
Empleado	
Comerciante	
Agricultor	
Profesionista	
Empresario	
Otro (especificar)	

8. Nivel académico del empresario

Sin estudios formales	
Primaria	
Secundaria	
Preparatoria	
Vocacional o Técnica	
Universidad	
Posgrado	

9. Ocupación anterior del empresario

Desempleado	
Empleado	
Comerciante	
Agricultor	
Profesionista	
Empresario	
Otro	

10. ¿Su ocupación anterior tuvo alguna relación con su actividad actual?

Si ( ) No ( )

11. ¿Cuál fue la razón más importante para iniciar el negocio?

Consejo de amigos o parientes	
Antecedentes/ conocimiento del negocio	
Relaciones con el negocio	
Búsqueda de independencia económica	
Deseo de iniciar un negocio propio	
Desempleo	
Otro (especificar)	

12. ¿Cuál fue la principal meta de iniciar el negocio?

Generar mayores ingresos	
Desarrollar ideas propias	
Otras	

C. Innovación

13. ¿Su empresa ha innovado productos o procesos productivos?

Si ( )   No ( )

14. ¿Su empresa recibió algún tipo de ayuda por parte del gobierno para promover la innovación de su producto y/o proceso productivo?

Si ( )   No ( )

15. ¿Realiza su empresa I&D a nivel local?

Si ( )   No ( )

16. ¿Qué tipo de I&D realiza?

Investigaciones básicas	
Investigación en alta tecnología	
Mejoramiento de productos terminados	
Mejoramiento de calidad	
Mercadotecnia (local o regional)	
Otro (cuál)	

D. Apertura Económica y Comercialización

17. ¿Cómo ha impactado en su empresa la apertura económica?

Concepto	**Aumento**	**Disminución**
Ventas		
Tecnología		
Rotación de personal		

18. ¿Cómo ha aprovechado la firma del Tratado de Libre Comercio para América del Norte? Opciones

19. ¿Su producto en el mercado nacional se ha visto desplazado por los productos importados?

Si ( )   No ( )

20. ¿A través de quién comercializa su producto?

Cuenta propia	
Comercializadora	
Tienda departamental	
Venta por pedido	
Subcontratación	
Otro (especificar)	

21. ¿A qué mercado dirige su producto?

Local	
Regional	
Nacional	
Internacional	

22. En caso de exportar, ¿qué factores lo impulsaron?

Calidad del producto	
Alta demanda externa	
Diferenciación del producto	
Precio competitivo	
Otras (especificar)	

23. ¿Asiste a ferias o exposiciones?

Visitante	
Expositor	
No asiste	

24. ¿Qué beneficios ha obtenido?

Adquisición de nuevas tecnologías	
Contacto con nuevos clientes	
Conseguir nuevos proveedores	
Actualización	
Otro (especificar)	

25. ¿Conoce usted los programas de apoyo gubernamental para exportar?

Si ( ) No ( )

26. ¿Cuenta con algún sistema de control de calidad?

Si ( ) No ( )

27. ¿Quién realiza el control de calidad?

Dueño	
Empleados durante el proceso	
Empleado con experiencia dedicado a la revisión	
Departamento específico	
Otro (especificar)	

28. ¿Cuenta con alguna norma internacional de calidad?

Si ( ) No ( )

Competitividad

29. ¿Cómo califica a su empresa en términos de competitividad en la rama?

Alta	
Media	
Baja	

30. ¿A qué factores atribuye este desempeño?

Costos	
Calidad	
Precio	
Comportamiento de la demanda	
Diferenciación	
Otro (especificar)	

31. ¿Qué porcentaje de su producto está conformado por materias y/o productos importados?

____

E. Calidad de los recursos humanos y relaciones laborales

32. ¿Cuál ha sido su nivel de empleo?

Año	**Empleados**
1996	
1997	
1998	

33. ¿Cómo determina el nivel de salario de su empresa?

Productividad de la mano de obra	
A través del sindicato	
Empresas de la misma industria	
Empresas de otras industrias	
Lineamientos del gobierno	
Otro (especificar)	

34. ¿Cuál es la rotación de personal que presenta su empresa?

35. ¿Cuál es el tiempo promedio de antigüedad de servicio de sus empleados?

Menos de 1 año	
Entre 1 y 2 años	
Entre 2 y 5 años	
Entre 5 y 10 años	
Más de 10 años	

36. ¿Cuál es el nivel educativo de su personal?

Instrucción	Número de empleados
Sin instrucción formal	
Primaria	
Secundaria	
Preparatoria	
Universidad	
Vocacional o Técnica	
Otro (especificar)	

37. ¿Qué mecanismos de capacitación utiliza para su personal?

Entrenamiento en el trabajo	
Cursos en la empresa	

Entrenamientos nocturnos	
Envío a cursos con financiamiento	
Utiliza instituciones públicas	
Utiliza instituciones de educación superior	
Otro (especificar)	

38. ¿Están sus trabajadores afiliados a un sindicato?

Si ( ) No ( )

39. ¿Cómo califica sus relaciones con el personal de su empresa?

Buenas	
Regulares	
Malas	

F. Programas de apoyo gubernamental .

40. ¿Con qué nivel de gobierno es con el que mayor trato mantiene?

Municipal	
Estatal	
Federal	

41. ¿Está usted enterado de las políticas y programas actuales del gobierno para promoción de las micro y pequeña empresas?

Si ( ) No ( )

42. ¿Cómo obtuvo información al respecto?

Medios masivos	
Agencias de gobierno	
Compañeros de negocio	
Bancos	
Otros (especificar)	

43. ¿Qué tipo de apoyo ha recibido por parte del gobierno?

Financiero	
Capacitación	
Promoción	
Asesoría	
Otro (especificar)	

44. Evaluación de los Programas del Gobierno

Programa	**B**	**R**	**M**	**Ranking**
a) Condiciones de acceso al financiamiento de fomento				
b) Servicios de consultoría y capacitación gubernamentales				
c) Trámites vinculados al comercio exterior				
d) Instrumentos de promoción a las exportaciones				
e) Servicios ofrecidos por instituciones públicas				
f) Regulación y control de las importaciones				
g) Seguridad jurídica				

h) Calidad de la infraestructura				
i) Calidad de los servicios públicos				

G. Financiamiento

45. Capital contable

Año	Monto
1996	
1997	
1998	

46. Activos y Pasivos de la empresa

Año	Activos	Pasivos
1996		
1997		
1998		

47. ¿De dónde provino su capital inicial?

Ahorros propios	
Financiamiento Bancario	
Préstamo de familiares	
Programas gubernamentales	
Tarjeta de crédito	
Crédito informal (especificar)	
Otros (especificar)	

48. ¿Cuál ha sido su nivel de utilidad en los últimos tres años?

Año	Utilidad %
1996	
1997	
1998	

49. ¿Cuál fue el destino de sus utilidades en el último año?

Compra de maquinaria y/o equipo	%
Materias Primas	%
Pago de Pasivos	%
Contratación de personal	%
Ampliación de la planta	%
Consumo Personal	%
Otros (especificar)	%

50. ¿Qué porcentaje de sus utilidades es reinvertido en su empresa?

Año	%
1996	
1997	
1998	

51. ¿Ha recibido algún crédito en los últimos doce meses?

Si ( )   No ( )

52. ¿A qué plazo y a qué tasa de interés?

Plazo	
Tasa de interés	

53. ¿Por qué prefirió esta vía de financiamiento?

Plazo de pago	
Tasa de interés atractiva	
Requerimientos mínimos garantía	
Otros (especificar)	

H. Relaciones interempresariales

54. ¿Cuáles tipos de relaciones interempresariales tiene usted con otras empresas?

Comprador de insumos de materias primas	
Comprador de insumos componentes	
Proveedor de insumos de materia prima	
Proveedor de insumos componentes	
Convenios I&D	
Otra (especificar)	

55. Sus relaciones interempresariales son con empresas:

Micro	
Pequeñas	
Medianas	
Grandes	

56. ¿Mantiene algún tipo de convenio para operar como proveedor de empresas transnacionales?

Si ( )   No ( )

57. ¿Sostiene acuerdos para compras gubernamentales? ¿Con qué nivel de gobierno?

Si ( )   No ( )

58. ¿Ha desarrollado redes de proveedores?

Materias Primas	
Bienes Intermedios	
Otros (especificar)	

59. ¿Su empresa subcontrata o recibe subcontratos?

Si	
Subcontrata	
Recibe subcontratos	
Ambos	
No	

60. ¿Cuál es la principal razón por la que recibe subcontratos?

Estabilización de operaciones	
Incremento de ventas	
Solicitud de la casa matriz	
Cooperación mutua	
Otra (especificar)	

61. ¿Qué proporción de las ventas las obtuvo por subcontratos?

Ventas	%

62. ¿Cuáles son los tres principales apoyos que recibe de su contraparte? Ordenar por órden de importancia

Abastecimiento de materia prima	
Asistencia técnica	
Asistencia administrativa	
Asistencia financiera	
Surtido de equipo	
Otra (especificar)	

63. ¿La subcontratación le ha ayudado a obtener un ingreso mayor a su negocio?

Si ( ) No ( )

64. Si forma parte de una red de subcontratación, ¿comparte información proveniente de la I&D de su contraparte?

Si ( ) No ( )

65. ¿Es usted miembro de alguna asociación empresarial?

Cámara de comercio	
Asociación de industriales	
Cámaras de industria	
Cooperativa	
Asociación de comerciantes	
Asociación civil	
Otra (especificar)	

66. ¿Qué tan útiles son estas asociaciones para usted o su negocio?

Oportunidad para relaciones sociales	
Obtención de materias primas	
Posibilidades de ventas	
Posibilidades de financiamiento	
Información	
Otras (especificar)	

67. ¿Ha logrado complementar procesos productivos, expandir su mercado o generar nuevos negocios a partir de la asociación empresarial a la que pertenece?

Si ( ) No ( )

68. ¿Ha recibido algún tipo de asesoría y consultoría por parte de la asociación a la que pertenece?

Financiamiento	
Fiscal	
Jurídica	
Otra (especificar)	

I. Modernización administrativa y acceso tecnológico

69. ¿Tiene la empresa objetivos globales por escrito?

Si ( ) No ( )

70. ¿Cuál es el horizonte de planeación de su empresa?

Menos de 1 año	
Entre 1 y 2 años	
Entre 2 y 3 años	
Más de 3 años	

71. ¿Existe un manual de organización donde se describan las funciones de cada puesto dentro de la empresa?

Si ( ) No ( )

72. ¿Se llevan y mantienen registros contables de las operaciones de su negocio?

Si ( ) No ( )

73. ¿Utiliza usted sistemas computarizados?

Si ( ) No ( )

74. ¿Con qué fin usa usted estos sistemas de cómputo?

Planeación y control de la producción	
Tareas de oficina	
Uso personal	
Otras (especificar)	

75. ¿Tiene usted fax?

Si ( ) No ( )

76. ¿Está pensando en desarrollar su propia tecnología o piensa importarla?

Desarrollo de tecnología	
Importarla	

77. ¿Cuáles son las principales fuentes de donde obtiene tecnología?

Comercializadoras de patentes	
Revistas especializadas	
Cámaras o Asociaciones	
Clientes u otros empresarios	
Empresas Transnacionales	
Instituciones Públicas	
Instituciones de Educación Superior	
Exposiciones o ferias	
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