Guerrero, Oaxaca, and Chiapas house 11% of Mexico's people, but 32% of those in extreme poverty.

The current administration's flagship program for developing these states will develop three Special Economic Zones (SEZs) to attract manufacturing companies to the area. However,

Exports are changing.

SEZs will support traditional sectors with promise: a new petrochemical plant, textiles, electronics assembly. But what about less traditional exports?

Productive policies must also change.

Oaxaca's mezcal exports are buzzing, but you make mezcal close to the agave, not in an industrial plant. Guerrero's returning diaspora will have the English skills to man call centers, and these can't be stopped by roadblocks and protests.

Special Economic Funds expand SEZs to new sectors.

Part Venture Capital, part Special Economic Zone, SEFs leave sector choosing to the private sector, promoting job creation wherever entrepreneurs find it.

Mezcal production in Oaxaca, Mexico

Call center operation in El Salvador

Shopping center in Acapulco, Guerrero

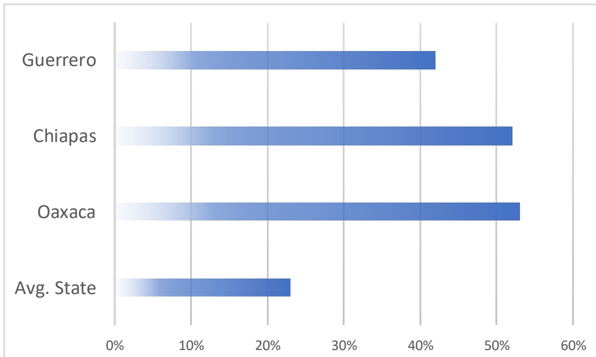
Image credits (clockwise): Bazar-artesanal.com, ProMéxico, VICE News.

CONTEXT

Mexico’s growth problem starts in the South.

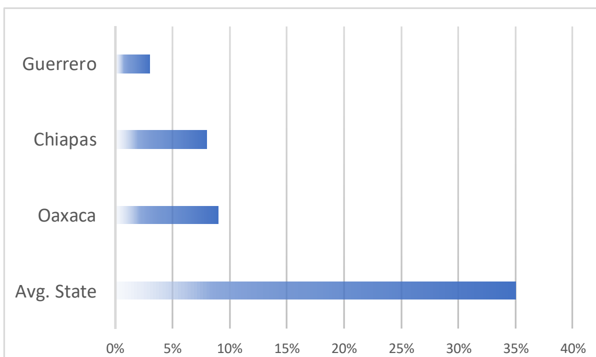
Compared to the rest of Mexico, the South is much more rural...

Proportion of population that is rural, 2014



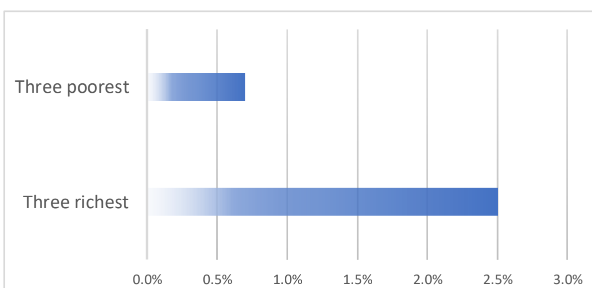
... exports much less...

Non-mineral exports as proportion of state GDP, 2014



... and is barely growing.

Real MXN GDP per capita growth rate, 10 year avg. for the richest and poorest states



ANALYSIS

The South is stuck because it is fragmented.

The binding constraints to growth in the region are:

- Information externalities, namely the costs of finding business models relevant to the area,
- Coordination externalities, which keep the region in a “productivity trap”
- Micro risks, such as expropriation, unexpected costs due to demonstrations and political action, etc.

These constraints persist due to **fragmentation**, which arises due to the ruggedness of the territory, the degree to which the population is rural, and the historical cultural diversity of the region.

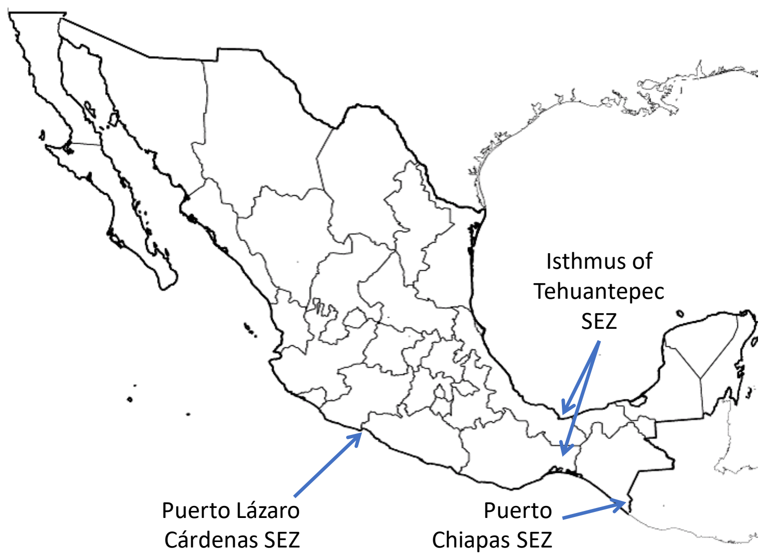
The long run challenge is to address the root causes of this fragmentation. In the meantime, we must support business models that can thrive in these conditions.

GROWTH DIAGNOSTICS

The Growth Diagnostics methodology aims to find the *binding constraints* to growth in a particular country or region, and understand the *syndrome* which keeps the market from correcting those constraints. Full-length diagnostics for Chiapas and Oaxaca inform this section.

ANALYSIS

SEZs are Mexico's new flagship productive policy.



Three initial SEZs provide multiple benefits for manufacturing industries:

- An industrial area with plots ready for construction and streamlined permitting
- A package of tax, regulatory and financing incentives
- Major transport infrastructure improvements

The Federal Government has prioritized implementation, so these initial zones will launch within twenty months.

ANALYSIS

While the success of SEZs would be transformational for the South, the risk of failure is also very high.

Success would be transformational...

- US$41bn private investment in 48 investment projects over 15 years
- This is larger than the region's GDP of US$32bn, and over five times current FDI levels of US$0.5bn

... but the risk of failure is high.

- It is harder to industrialize today than in the 1990s
- In today's political climate, Mexican manufacturers may soon find it harder to access the US market
- Past attempts to industrialize the South have failed to attract investment
- The infrastructure component of the SEZs is at risk due to budgetary pressure

Special Economic Funds (SEFs) expand the SEZ program to non-manufacturing activities.

POLICY RECOMMENDATION

SEFs expand the benefits of the SEZ program, whether the South industrializes or not.

There is room for a complement to SEZs within existing legislation. We propose the creation of Special Economic Funds, a figure to complement SEZs, with these features:

- Corporation with private investors, local governments, and federal governments as shareholders.
- Run by professional management who look for investment opportunities that generate employment in the South.
- When a company accepts a bid from the SEF, it surrenders an equity stake in exchange for two assets: capital, and a special status as a company in a Special Economic Zone whose administrator is the Fund.

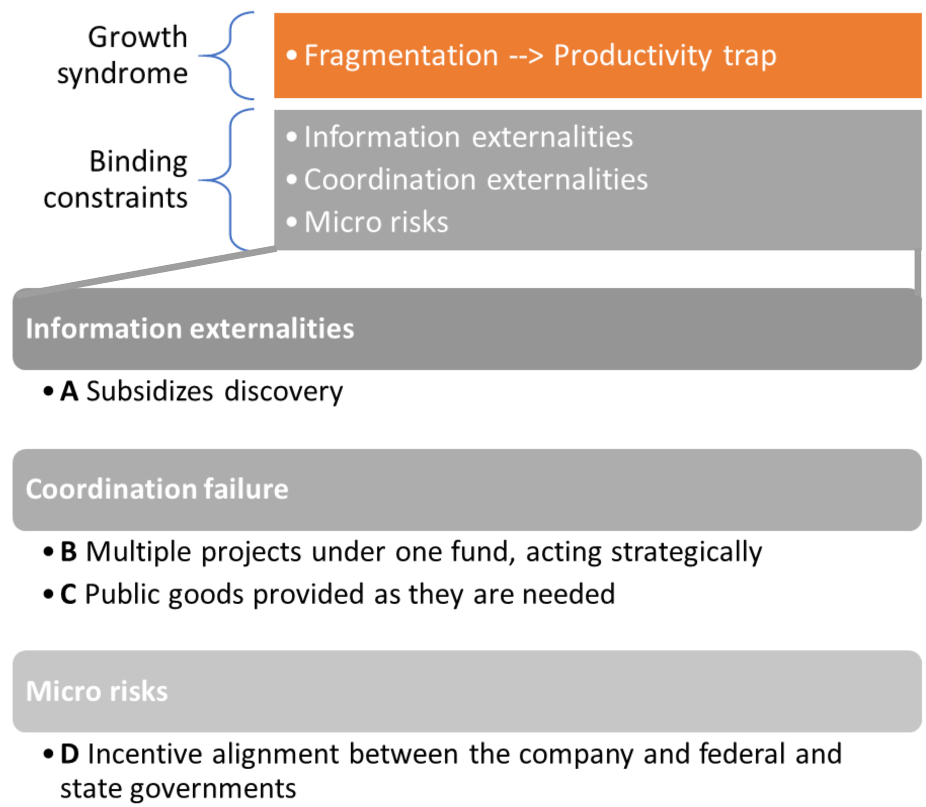
SEFs are designed to comply with three design criteria[1] for effective productive policies:

- Embeddedness - by leaving the "choosing of winners" to the private sector.
- Carrots and sticks - encourage investment in the South.
- Accountability - with time limits and transparency.

POLICY RECOMMENDATION

SEFs encourage the creation of firms that find ways around fragmentation.

This diagram summarizes how:



Rodrik, Dani "Industrial Policy- Don't Ask Why, Ask How." Middle East Development Journal 1, no. 1 (June 1, 2009): 1–29.