

**Testimony to the Select Committee on California-Mexico Cooperation
Sacramento, California**

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May 5, 2015**

Mr. Chairman and members of the Select Committee on California-Mexico Cooperation:

My name is Pedro Noyola. I am President of *aklara*, a US professional services company devoted, primarily, to the design and execution of procurement contests. *aklara* was founded in 2000 as a Delaware corporation authorized to domicile in California. The company wholly-owns a subsidiary in Mexico, where most of its clients are located.

aklara's mission is to create market contests, principally through structured auctions, that generate efficient, effective and transparent results: efficient, by maximizing competition and revealing optimal prices; effective, by promoting adjudication and contractual compliance; and transparent, by binding all parties to explicit rules and traceable actions.

Since its establishment, *aklara* has designed and executed over 9,500 auctions for more than 150 clients. To date, *ex-ante* aggregate transactional value exceeds 21 billion dollars and the company's horizontal experience expands to more than 180 goods and services. *aklara's* market events have generated savings of about 2.5 billion dollars, equivalent to about 12% of expected prices.

Before founding *aklara*, I taught economics at the *Universidad Autónoma de Barcelona*, served in Mexico's federal government as Undersecretary of Trade and Undersecretary of Finance, and co-founded *SAI Consultores*, a Mexican law and economics firm specialized in matters of competition, trade and finance.

I come before you to comment on three aspects of the Mexican economic ecosystem that I believe are particularly relevant to California's economy: first, its openness; second, its integration to North America; and third, the quality of competition and economic transparency within its markets.

On Openness:

In 1986, I was teaching mathematical economics in Spain and working on a research project to predict the fiscal and distributive impacts of the introduction of a national value-added tax, which

at the time was a prerequisite to Spain's accession to the European Economic Community. One lazy summer afternoon, after completing the research project and while pondering if I should accept a long-term appointment at the University, I received a call inviting me to return to Mexico and join a team that would be tasked with crafting, first, a significant tax reform and, then, a long-term trade policy. Although the prospect of pursuing my academic interests at a fine and dynamic university appealed to me greatly, I decided to return to Mexico and engage in, what I thought at the time would be, a short-term tour of duty in civil service.

When I landed in Mexico City later that summer, I found a country struggling to rid itself of entrenched protectionist demons that greatly contrasted with the outward-looking spirits that dominated public and private discourse in the Spain I had just left behind. At the time, Mexico's weighted average import tariff exceeded 15%. This figure underestimated the highly distortive effects of the trade regime because tariff dispersion reached double digits and many items were subject to quantitative restrictions that, in some cases, made the equivalent tariff extraordinarily high. Not surprisingly, the Mexican economy in 1986 was quite closed: the international trade over GDP ratio barely reached 20%.

Fast forward to 2015: today, both the weighted average import tariff and tariff dispersion are less than 5%, and there are no quantitative restrictions to trade, other than for sanitary and safety reasons (toxic and hazardous materials, contaminated food, etc.) Unsurprisingly too, the Mexican economy today is quite open: the current foreign trade to GDP ratio approaches 70%.

On North American Integration and Competitiveness:

In 1989, after helping design and implement comprehensive income tax reform, I moved to the trade front. To make a long story short, an ambitious regional agenda complemented Mexico's multilateral commitments and resulted in the negotiation of several free trade agreements, including NAFTA, which was enacted 21 years ago, in 1994.

By all trade measures, NAFTA contributed to make North America a more efficient and integrated economy: since 1994 intraregional trade quadrupled and intraregional foreign direct investment quintupled. One current statistic stands out to me: the average US content of goods imported into the US from Mexico is about 40% of total cost. In contrast, the US content of Chinese imports into the US is, on average, about 4% of total cost. Now that such a clear pattern of shared regional production has emerged, I think we can safely state that data, even more than logic and reason, ultimately and massively debunked the apocalyptic "great sucking sound" theory espoused by NAFTA's opponents. But perhaps California does create a sucking sound of sorts: that of the \$25 billion dollars of exports that are sucked into the Mexican economy every year.

NAFTA also increased macroeconomic coordination. Prior to 1994, Mexico's growth cycle was statistically countercyclical to the US cycle, and interest rates and inflation in both countries were largely uncorrelated. In contrast, a recent statistical test of co-integration, the so-called

Johansen test, showed that for short-term interest rates, inflation rates and economic growth rates, the null hypothesis that those variables remain uncorrelated in the NAFTA region must be rejected. In other words, North American macroeconomic coordination today is much more than the title of that great Police album: “Synchronicity.”

NAFTA also structurally boosted the region’s competitiveness. What I mean is that, *ceteris paribus*, North American firms are more competitive post-NAFTA than they were pre-NAFTA. For example, consider the following three drivers that, as a result of increasing co-integration, help make North American firms more competitive *vis-à-vis* competitors in the world’s fastest growing market: China. First, the demographic driver: NAFTA’s dependency ratio (population over the age of 64 divided over population aged between 15 and 64) is lower in North America than it is in China. Second, a supply side argument: NAFTA’s energy and transportation costs are lower in North America than they are in China. And third, a green argument: NAFTA’s marginal investment requirements to reach the so-called 450 Scenario are lower in North America than they are in China.

On Competition and Economic Transparency

In the mid-nineties, Mexico introduced a new competition law that gradually and systematically strengthened competitive forces in many sectors. However, insufficient and deficient competition continues to drag the economic ecosystem, especially in certain non-tradable sectors. For example, relative to the US, Mexico’s Herfindahl Index, which measures supplier concentration, is 5 times higher in the oil sector, 10 times higher in the electricity sector and 2.5 times higher in telecommunications and land transportation. Overall, supply of non-tradable goods and services is about 3 times more concentrated in Mexico than in the US. More concentration generally leads to less and worse competition, and to an erosion of consumer surplus. This is not good.

Moreover, Mexican government spend is often shackled by procurement rules that limit efficient, effective and transparent competition. This negatively impacts the overall economy’s competitive environment for two reasons: first, size matters: distortions in government expenditure markets have significant ripple effects on the rest of economy; and second, the demonstration effect: government practices significantly influences the culture of doing business in the country.

In 2009, the procurement law was reformed to introduce structured auctions and improve the quality of competition in public purchasing, augment public savings and increase accountability and transparency. The reform was limited to purchases of goods and services and excluded public works contests, but it at least opened a window to a new procurement paradigm.

Here, I transition to my transactional experience at *aklara*. In 2000, after spending almost two decades of my professional life in academia, public service and private consulting studying, designing and implementing economic policies to help make the Mexican economy more open,

integrated and competitive, I recognized that the quality of competition was still an Achilles heel that eroded efficiency, perpetuated rent-seeking and, in many cases, promoted self-reinforcing corrupt practices.

So I set about to provide a transactional solution that would determine prices more efficiently and transparently than bilateral negotiations or restrictive sealed-bid contests, and *aklara* was born. When the 2009 procurement law was enacted, government agencies began to solicit *aklara's* market-making services to help them design federal requests for proposals and quotations, and *aklara* put auction theory and technology to work in government purchases.

Since 2009, *aklara* has designed 995 electronic auctions for various government agencies, including the *Secretaría de Educación Pública* (SEP), the *Instituto Mexicano del Seguro Social* (IMSS), the *Comisión Federal de Electricidad* (CFE) and *Petróleos Mexicanos* (Pemex). To date, *ex-ante* aggregate auction spend surpasses 8 billion dollars; average savings total almost 1 billion dollars (a measure of efficiency); adjudication rates approach 94% (a measure of effectiveness); and contests are consistently sanctioned favorably by *Transparencia Mexicana* (a measure of transparency).

The successful auctions executed since 2009 are only drops in the bucket: too many public procurement markets remain highly concentrated, too many comfort zones remain unchallenged and the shadow of corruption still hovers over too many contests. Mexico, of course, does not have a monopoly on inefficient government procurement. I can't help but wonder, for example, about the amount of consumer surplus lost each year in California to inefficient price dynamics and established comfort zones in state and municipal procurement contests. On this issue, Mexico's recent experiments with structured auctions are worthy of note.

Moving forward, I expect the government to move steadily towards more auction-based contests. This would be consistent with the policies of openness, integration and competitiveness that, together, define the last 25 years of Mexican microeconomic policy.

So I conclude with an optimistic outlook. If Mexico sustains its commitment to modernity and reinforces competition and transactional transparency, I foresee a brilliant future for the bilateral economic relationship between two nations that are neighbors by destiny and partners by choice.

Thank you for your attention and I look forward to our conversation.