The Structural Reform Process in Mexico: Recovering the Growth Path

José Antonio Murillo

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There is a renewed interest in Mexico

- Solid macroeconomic fundamentals
  - Prudent government finances
  - Moderate external deficit with large liquidity buffers
  - Low inflation and a flexible exchange rate regime

- Recent gains in external competitiveness
  - Flat unit labor costs
  - Increased manufacturing productivity

- Favorable demographic dynamics
  - Growing workforce with falling dependency ratio

- Strong momentum in current structural reform program
Solid Fundamentals

Fiscal Deficit % of GDP 2012

- ESP: 10.3%
- JAP: 10.2%
- USA: 8.5%
- FRA: 4.6%
- ITA: 3.0%
- BRA: 2.8%
- MEX: 2.6%
- DEU: -0.2%

Banking Sector Capitalization Index %

- 2008: 15.4%
- 2009: 15.9%
- 2010: 17.1%
- 2011: 16.4%
- 2012: 15.5%

International Reserves plus IMF FCL USD billion

Source: Banco de México, CNBV and IMF
Increasing External Competitiveness

**Manufacturing Index**
2003 = 100

- **Mexico**
- **USA**

**Manufacturing Wage**
USD/hour

- **Mexico**
- **China**

**Forecast**


**Unit Labor Costs**
2003=100

- Hong Kong
- Indonesia
- Corea del Sur
- Filipinas
- Taiwán
- Tailandia
- Hungría
- Brasil
- México

Source: Banco de México, Bank of America Research, Bloomberg and INEGI
Strong Demographics

Age Cohort Distribution
% of total population

Dependency Rate and Workers
dependents / working age population and million

Source: CONAPO and UN
Five “deep” reforms in almost 20 years…

- NAFTA
- Banxico’s autonomy
- Siefores/Afores
- Budget & fiscal responsibility law
- Public pension system reform
Five “deep” reforms in almost 20 years vs 8 reforms in 11 months…that could be 10 or 12 in one year
Full authority over schools’ syllabi to the government;
- Full-fledged professional structure for teachers;
- New autonomous institution to certify and evaluate students’ and teachers’ performance;
- Periodic censuses to build a national registry of schools, professors and students; and
- Extended school day – from 6 to 8 hours – for 40 thousand “full time” schools where lunch will be served.

Telecommunications Reform

- Creates an industry regulator able to label as “dominant” any company with more than 50 percent of the telecoms or television markets;
- Raises the legal maximum shareholding of foreign investors in companies operating in the sectors;

Local Services (% of subscriber lines)

- Telmex 96%
- Axtel 3%
- Others 1%

Mobile (% of subscribers)

- Telcel 77%
- Nextel 2%
- Iusacell 4%
- Unefon 3%

Data (% of service Revenues)

- Others 9%
- Alestra 9%
- Avantel 14%

Pay TV (% of subscribers)

- Telmex 68%
- Megacable 11%
- Cablemas 11%
- MVS 19%
- Others 28%

Canadian Households with Broadband (% of households)

Note: Market share data is for 2005 and Broadband for 2011 or latest (see OECD Communications Outlook 2013).
Fiscal reform

**Objectives:** Enhance public finances through the reduction of the dependency on oil revenues, increasing tax collection and making spending more transparent

**Main points:** Extends VAT, more progressive income tax, to food and medicines, reduce income tax exemptions and simplify tax payments

**Proposal:** September 2013

**Approved on October 31**

**Impact on potential GDP:** 0.5%

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**Oil and non-oil revenues**

<table>
<thead>
<tr>
<th>Year</th>
<th>MXNbn</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>750</td>
</tr>
<tr>
<td>2002</td>
<td>1,250</td>
</tr>
<tr>
<td>2004</td>
<td>1,750</td>
</tr>
<tr>
<td>2006</td>
<td>2,250</td>
</tr>
<tr>
<td>2008</td>
<td>2,750</td>
</tr>
<tr>
<td>2010</td>
<td>3,250</td>
</tr>
<tr>
<td>2012</td>
<td>3,750</td>
</tr>
</tbody>
</table>

- **Oil:** 66.3%
- **Non-oil:** 33.7%

**Tax collection**

<table>
<thead>
<tr>
<th>Country</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>33.8</td>
</tr>
<tr>
<td>Belgium</td>
<td>33.8</td>
</tr>
<tr>
<td>Norway</td>
<td>33.8</td>
</tr>
<tr>
<td>Finland</td>
<td>33.8</td>
</tr>
<tr>
<td>Netherlands</td>
<td>33.8</td>
</tr>
<tr>
<td>Slovenia</td>
<td>33.8</td>
</tr>
<tr>
<td>Germany</td>
<td>33.8</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>33.8</td>
</tr>
<tr>
<td>Estonia</td>
<td>33.8</td>
</tr>
<tr>
<td>Sweden</td>
<td>33.8</td>
</tr>
<tr>
<td>Ireland</td>
<td>33.8</td>
</tr>
<tr>
<td>Portugal</td>
<td>33.8</td>
</tr>
<tr>
<td>Greece</td>
<td>33.8</td>
</tr>
<tr>
<td>Switzerland</td>
<td>33.8</td>
</tr>
<tr>
<td>Japan</td>
<td>33.8</td>
</tr>
<tr>
<td>Australia</td>
<td>33.8</td>
</tr>
<tr>
<td>United States</td>
<td>18.8</td>
</tr>
</tbody>
</table>

**Average OECD:** 33.8%

Source: Banorte-Ixe with data from OECD and SHCP
Main features…

- Even though it did not include VAT on food and medicine items, this is the most significant fiscal reform proposed in the last 15 years.
- It reduces Pemex tax burden from 79% to 60%.
- Elimination of special treatments, preferential regimes, deductions and exemptions to VAT payments.
- Harmonization of VAT rate in border and Quintana Roo.
- New excise taxes to sweetened beverages, junk food, and pesticides.
- New incorporation regime for small and medium taxpayers.
- Elimination of tax on cash deposits (IDE).
- New gasoline price policy and rights on fossil fuels.
- More progressive in terms of personal income tax.
Government intends to raise revenues in 1.4% of GDP

**Expected revenues derived from the fiscal reform in 2014**

<table>
<thead>
<tr>
<th></th>
<th>% GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>1.4</td>
</tr>
<tr>
<td>Corporate income taxes</td>
<td>0.7</td>
</tr>
<tr>
<td>Personal income taxes</td>
<td>0.3</td>
</tr>
<tr>
<td>VAT</td>
<td>0.3</td>
</tr>
<tr>
<td>Non-oil excise taxes</td>
<td>0.2</td>
</tr>
<tr>
<td>Gasoline excise taxes</td>
<td>0.4</td>
</tr>
<tr>
<td>Rights</td>
<td>0.1</td>
</tr>
<tr>
<td>Elimination of IETU</td>
<td>-0.7</td>
</tr>
</tbody>
</table>

Source: MoF
**Financial reform**

**Bank penetration**

<table>
<thead>
<tr>
<th>Country</th>
<th>% GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chile</td>
<td>72.0</td>
</tr>
<tr>
<td>Brazil</td>
<td>45.5</td>
</tr>
<tr>
<td>Colombia</td>
<td>41.4</td>
</tr>
<tr>
<td>Peru</td>
<td>23.1</td>
</tr>
<tr>
<td>Mexico</td>
<td>14.7</td>
</tr>
</tbody>
</table>

**Objective:** Increase bank penetration in Mexico aiming to achieve the democratization of high productivity among companies and facilitate consumption smoothing for individuals from all social classes.

**Main points:**
- Improve enforcing contracts processes for commercial banks, guarantees programs for development banks and financial non-banks regulation.
- Tentative proposal: August 2013
- Tentative approval: December 2013
- Impact of potential GDP: 0.75%

**Enforcing contracts index***

**Bank penetration in Mexico**

- **Merchantile contracts. Source:** Banorte-Ixe with data from Banxico and World Bank
Energy reform

**Objectives:** Take better advantage of energy resources, in particular fossil fuels

**Main points:** Allow private—domestic and foreign—participation in exploration, oil production in deep seas and shale gas. Increase and make more transparent participation mechanisms in exploration and production of crude oil in shallow waters

**Proposal:** August 2013

**Tentative approval:** December 2013

**Impact on potential GDP:** 1%

**Shale gas reserves**

tcf

<table>
<thead>
<tr>
<th>Region</th>
<th>tcf</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>1,931</td>
<td>U.S. 862 Mexico 681 Canada 388</td>
</tr>
<tr>
<td>South East Asia</td>
<td>1,389</td>
<td></td>
</tr>
<tr>
<td>South America</td>
<td>1,225</td>
<td></td>
</tr>
<tr>
<td>Africa</td>
<td>1,042</td>
<td></td>
</tr>
<tr>
<td>Europe</td>
<td>639</td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>396</td>
<td></td>
</tr>
</tbody>
</table>

Source: Banorte-Ixe with data from SENER
The challenge will be to migrate from conventional fields

\[
\begin{array}{|c|c|c|}
\hline
\text{Cuencas del Sureste} & 45.4 & 24.4 & 20 \\
\text{Tampico-Misantla} & 6.2 & 0.7 & 3 \\
\text{Chicontepec} & 0.3 & 16.7 & - \\
\text{Veracruz} & 0.7 & 0.3 & 2 \\
\text{Burgos} & 2.3 & 0.5 & 3 \\
\text{Deep water} & - & 1.7 & 27 \\
\text{Shale} & - & - & 60 \\
\text{Total} & 55 & 44.5 & 115 \\
\hline
\end{array}
\]

\(\frac{3}{4}\) of prospective resources are non conventional
## Main differences in parties proposals

<table>
<thead>
<tr>
<th></th>
<th>PAN</th>
<th>PRI</th>
<th>PRD</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Contracts</strong></td>
<td>Concessions (1)</td>
<td>Profit-sharing (2)</td>
<td>No proposal</td>
</tr>
<tr>
<td><strong>Main changes to Pemex</strong></td>
<td>Lower fiscal burden</td>
<td>Lower fiscal burden</td>
<td>Lower fiscal burden</td>
</tr>
<tr>
<td><strong>Compensation:</strong></td>
<td>Cash &amp; barrels</td>
<td>Cash</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Constitutional changes</strong></td>
<td>Art. 25,27,28</td>
<td>Art. 27 y 28</td>
<td>No</td>
</tr>
<tr>
<td><strong>Exploration &amp; production sector</strong></td>
<td>Open, through concessions</td>
<td>Open, through associations</td>
<td>No</td>
</tr>
</tbody>
</table>

(1) Private owns reserves and production.
(2) State owns reserves and profits form production are shared with the private entity.
Main issues

Hidrocarbons

1. New contract regime to regulate Pemex relations with private sector,
2. Pemex will have first pick on fields.
3. Opening the petrochemical industry to competition and private investment.
4. New tax regime for Pemex.
5. Pemex consolidation.

Electricity

1. New law to allow for competition in electricity generation and commercialization.
2. Open access to electricity generators to the transmission and distribution network.
Final Comments

- After decades of structural reform stagnation Mexico has found the way to reignite the process.

- The effect of most of the reforms will have a long term impact on potential growth.

- There are two reforms with a special effect on border economies: fiscal and energy.

  ✓ The energy reform will have a huge positive effect on the border economy.

  ✓ VAT harmonization not expected to have a huge effect on commerce.