OECD Economic Surveys: Mexico

Executive summary

Main findings

The new government has set an ambitious course of economic and social reforms (a key element of which is its recent *Pacto por México*), for which it has obtained broad political support. The policies of the past several years have positioned the country well in terms of macroeconomic and financial performance, but economic growth remains insufficient and more needs to be done to improve well-being. This *Economic Survey* puts forward reforms aimed to achieve higher income levels and better social conditions in Mexico.

In order to raise **long-term economic growth** by accelerating productivity and factor accumulation, structural reforms will be required across multiple institutional domains, as many of the problems are interlinked. This should include a follow-through of already-legislated reforms which need to be implemented – notably in the key areas of labour markets, competition and education. These reforms, however, are heavily attenuated by widespread informal employment and weak legal institutions that diminish the effectiveness of policies and hold back gains in productivity. New legislation and regulatory reform are needed to remove barriers to market entry, reduce corruption and make the civil justice system more effective.

Pressures on **natural resources and environmental outcomes** need to be taken into account as Mexico seeks to boost economic growth. Costs of environmental degradation represented 5% of GDP in 2011 and the country has made less progress than other OECD countries in decoupling CO_2 emissions from economic growth. The government has set ambitious emission reduction targets that will require new policy tools to be achieved. Removing fossil-fuel subsidies and introducing carbon pricing would be the most cost-efficient ways to accomplish these goals, and stricter emission standards also have a role to play to lower emissions in the transportation sector.

While **fiscal policy** continues to be prudent, public debt has increased during the recession, as in other countries, and the government budget is overly dependent on oil. The risk of decline in oil output, in the absence of energy reform, is a threat to fiscal stability. Fiscal buffers should be rebuilt over time to protect the economy against possible contingencies. Transitioning towards a new fiscal rule is also desirable to reduce the partial pro-cyclicality of the current framework. Moreover, the tax system could be made more efficient, by broadening the tax base, and it does not raise sufficient revenues to fight poverty, develop human capital and build infrastructure. Evaluating and removing tax expenditures and special tax regimes is necessary, especially those that erode the corporate income tax base, such as for the *maquiladoras*. Additionally, the system of fiscal federalism as it currently functions in Mexico has important shortcomings, with states and municipalities overly dependent on federal transfers to finance expenditure. The federal government should harden the budget constraints on sub-national governments by limiting further increases in transfers and avoiding extraordinary transfers. At the same time, debt ceilings and restrictions on deficits should be established to prevent unsustainable borrowing by local governments.

Remarkable progress has been made in reducing **poverty and inequality** over the past fifteen years. Still, social indicators remain unfavourable by international comparison, and poverty has increased once again during the recession. Mexico needs to strengthen its social policies to achieve a less unequal income distribution. Building on existing programmes will be important, as *Oportunidades, Seguro Popular* and *70 y más* have generally been successful, and should be expanded. However, strengthening the social safety net significantly will be costly, so improving the efficiency of the current system by reducing duplication among the numerous programmes and evaluating their effectiveness will be important. Building an unemployment insurance scheme would also be useful.

Key recommendations

Structural policies to boost growth

- Promote regulatory reform and remove entry barriers at all levels, particularly at the subnational level, building on progress at the federal level. Create a high-level inter-agency body focused on productivity that can study and advocate for structural reform.
- Seek to reduce informality through a broad-based package of policies: strengthen education and skills, reduce anti-competitive business regulation, improve the legal environment and tackle corruption.
- Complete the judicial reforms at the state level that move towards faster and more transparent trials in criminal cases. Empower an executive agency to promote the analogous transition for civil cases.
- Set up specialised economic courts with qualified judges to address economic regulation issues and support the effectiveness of the Competition Commission.
- Remove barriers to foreign entry in remaining sectors, building on unilateral tariff liberalisation.

Environmental protection and energy policies

- To ensure that the right price signals are provided, continue to remove fossil-fuel subsidies, and thereafter move towards carbon pricing.
- Similarly, promote energy efficiency in CFE electricity operations, so as to reduce government subsidies and carbon emissions. Reduce PEMEX's environmental footprint.
- Raise water service tariffs to reflect operation and maintenance costs of providing services.

Fiscal reform

- Move towards a structural fiscal rule to reduce the partial pro-cyclicality of the current framework.
- The fiscal stability law should be reformed to increase the build-up of financial buffers in liquid assets available in case of contingency or adverse market sentiment.
- Re-evaluate and remove special tax regimes, such as the one for the *maquiladoras*.
- Improve PEMEX's operational and environmental efficiency as well as governance, allowing much more reliance on private firms in the oil and gas sector, so as to increase output and generate gains for the federal budget.
- Establish a harder budget constraint on subnational governments to improve their tax collection by limiting further increases in transfers, avoiding extraordinary transfers and promoting the implementation of limits on deficits and debt ceilings.
- Fully implement the new general government accounting law to ensure greater transparency and accountability of local budgets.

Anti-poverty programmes

- Increase the coverage and size of *Oportunidades* cash transfers to the poor, complete the implementation of *Seguro Popular*, and broaden the coverage of *70 y más* old-age pensions.
- Evaluate and streamline social benefit programmes.
- Create a cost-effective unemployment insurance scheme and strengthen training programmes to help the unemployed find work.


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