Executive summary

Following a deep recession associated with a strong global downturn, Mexico is experiencing a robust recovery, with GDP growth of 5½ per cent in 2010 and 4½ per cent in 2011. Export growth is expected to slow after the exceptional rebound of 2010, but stronger domestic demand should keep the recovery on track. Several labour market indicators have improved, although unemployment is decreasing only slowly. Mexico has already started to withdraw the fiscal stimulus of 2009 and increased taxes to calm market worries about fiscal trends. If the recovery unfolds as expected, the government should fully implement its plans to lower the budget deficit further through spending restraint. Since inflation has come down, monetary policy can support the recovery by keeping rates low in the near term.

Mexico was able to implement countercyclical policies in the recession thanks to significant reforms of the macroeconomic policy framework. However, it should continue to strengthen its policy framework to better withstand shocks. Amending the fiscal rule to accumulate more financial assets during periods of high oil prices and economic growth would give the government additional room to support the economy when confronting large shocks. Taking measures to lower price stickiness related to administrative tariffs and uncompetitive markets would give monetary policy more room for manoeuvre and, most importantly, would contribute to a better allocation of resources. Enhancing competition and lowering market entry barriers would also promote the development of more stable consumer-related services, attenuating the effects of shocks.

Mexico needs to maintain growth-enhancing investments and social policies to catch up with average OECD living standards and reduce poverty. Therefore, the significant effort that has taken place in recent years to strengthen tax revenues should continue, particularly with a view of attaining a more efficient tax system with higher independence from oil revenues. There is also a great potential to increase revenues at the subnational level. This would make sure that Mexico can confront future spending pressures. The Mexican government has made significant efforts to close tax loopholes in recent years, mainly through the adoption of an alternative minimum tax on business income (Impuesto Empresarial a Tasa Unica, IETU). Yet, further efforts to remove inefficient tax expenditures would broaden the tax base, increase revenues and make the tax system simpler, thus reducing opportunities for tax avoidance and evasion. Mexico is in the process of increasing fossil-fuel prices, but this should be accelerated to eliminate subsidies and the associated negative effects on the environment. A targeted cash benefit would be more efficient to protect the poor.

Mexico's informal sector, which is large by OECD standards, is a drag on productivity growth. Firms in the informal sector lack access to credit, training and legal protection – so they do not innovate and remain small. Better education, enhanced regulation, and improved incentives to formalise are key reforms to combat informality, as will be stronger enforcement of labour and tax laws. The government should continue its efforts to reduce costs of starting and running a business and of employing workers formally. It should strengthen the value of the mandatory social security package for low-wage workers, while limiting its costs through efforts to raise efficiency.

Weak competition in many sectors and deficiencies in education have been a further brake on productivity. The OECD has co-operated with Mexico in all of these areas to develop a reform agenda. The competition law reform, which has now been passed in Congress, is an important step towards reducing market power of incumbents across all industries, as it will greatly strengthen cartel law enforcement. The quality of teaching could be further improved through stronger performance standards, better teacher training as well as more professional recruitment and school management.

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