

The Structural Reform Process in Mexico: Recovering the Growth Path

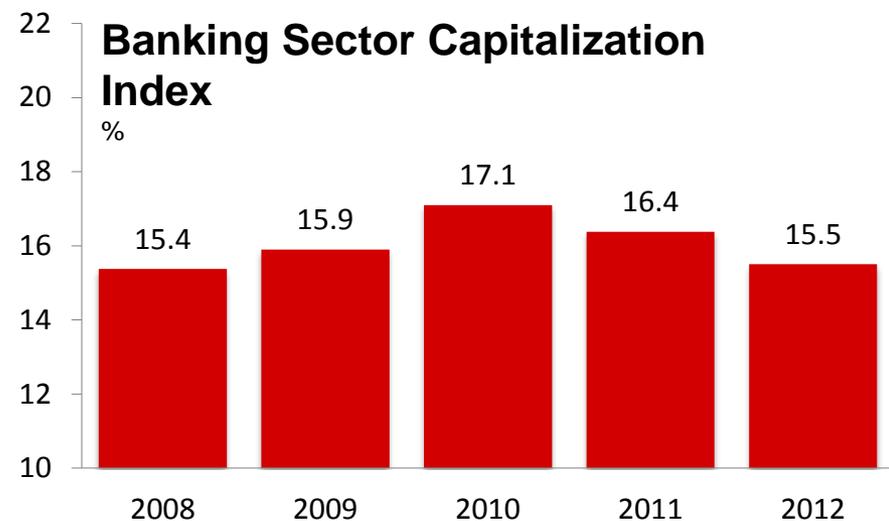
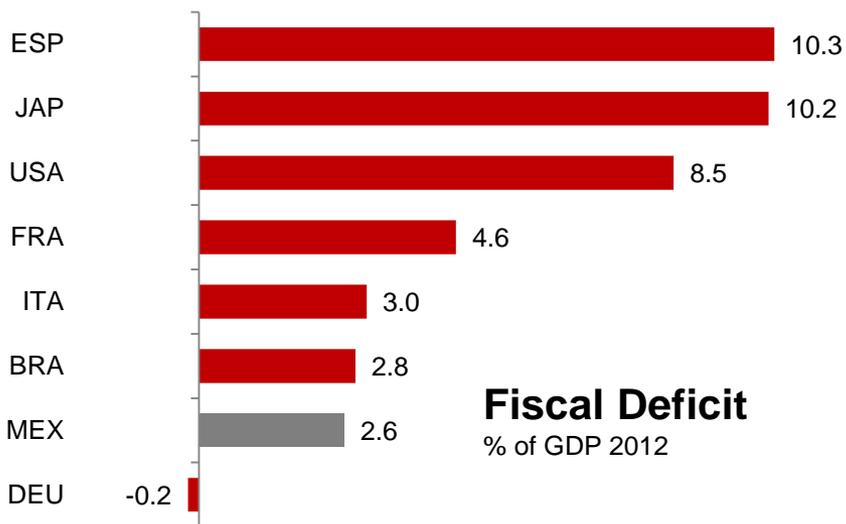
José Antonio Murillo

November 2013

There is a renewed interest in Mexico

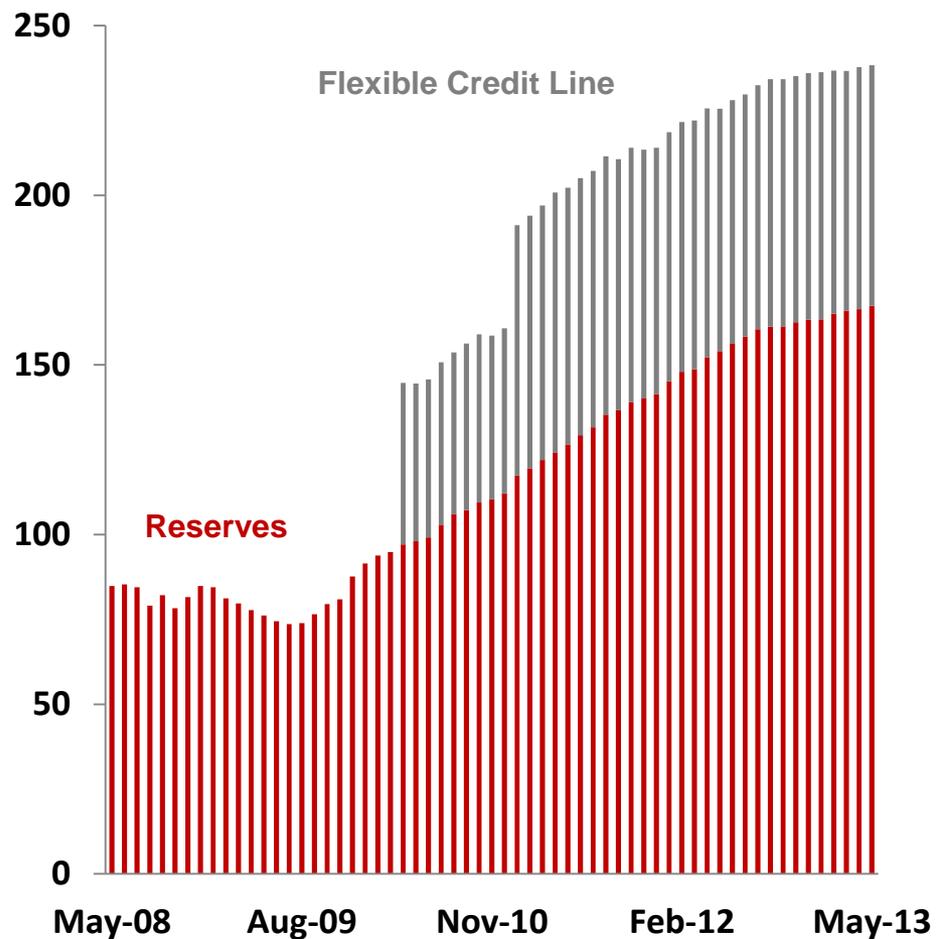
- **Solid macroeconomic fundamentals**
 - ✓ Prudent government finances
 - ✓ Moderate external deficit with large liquidity buffers
 - ✓ Low inflation and a flexible exchange rate regime
- **Recent gains in external competitiveness**
 - ✓ Flat unit labor costs
 - ✓ Increased manufacturing productivity
- **Favorable demographic dynamics**
 - ✓ Growing workforce with falling dependency ratio
- **Strong momentum in current structural reform program**

Solid Fundamentals



International Reserves plus IMF FCL

USD billion

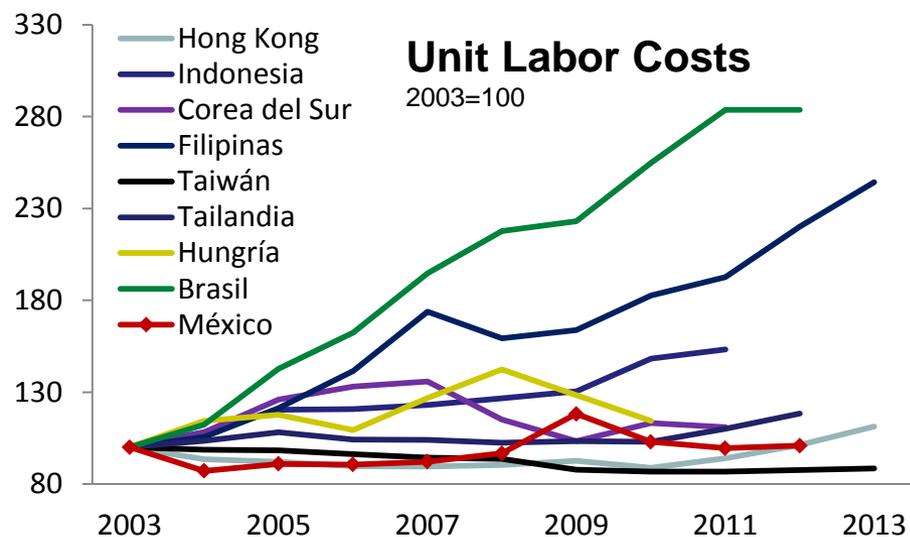
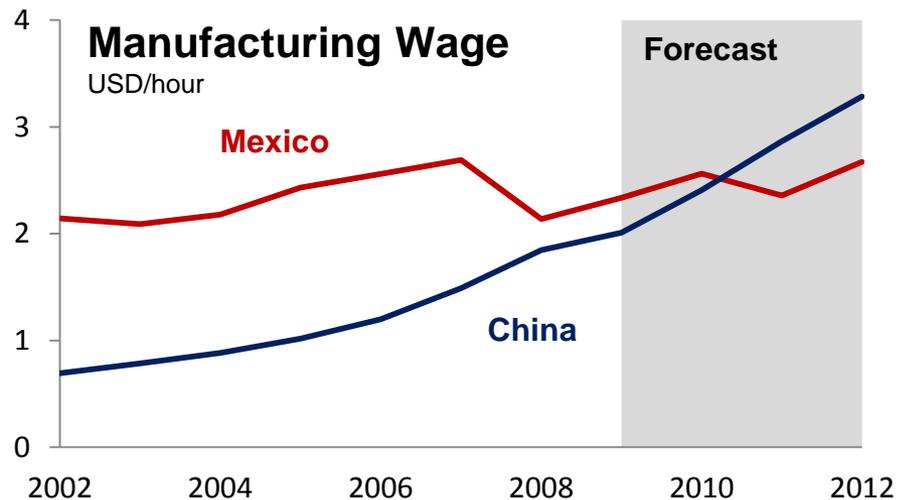
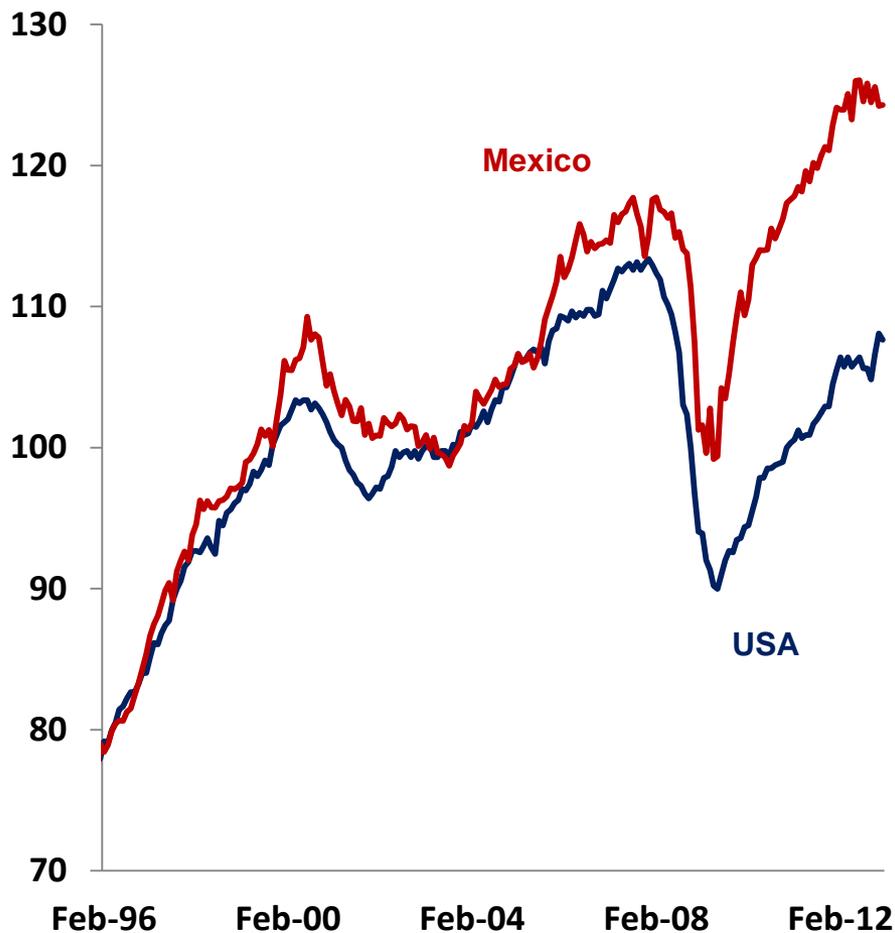


Source: Banco de México, CNBV and IMF

Increasing External Competitiveness

Manufacturing Index

2003 = 100

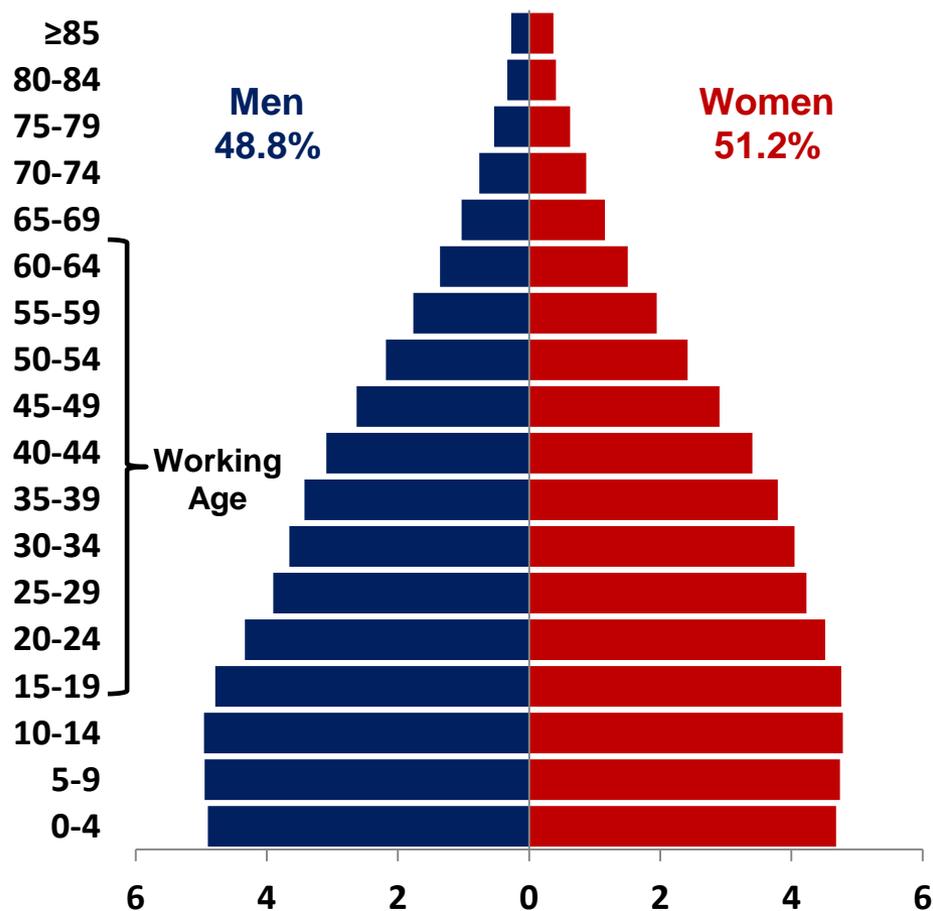


Source: Banco de México, Bank of America Research, Bloomberg and INEGI

Strong Demographics

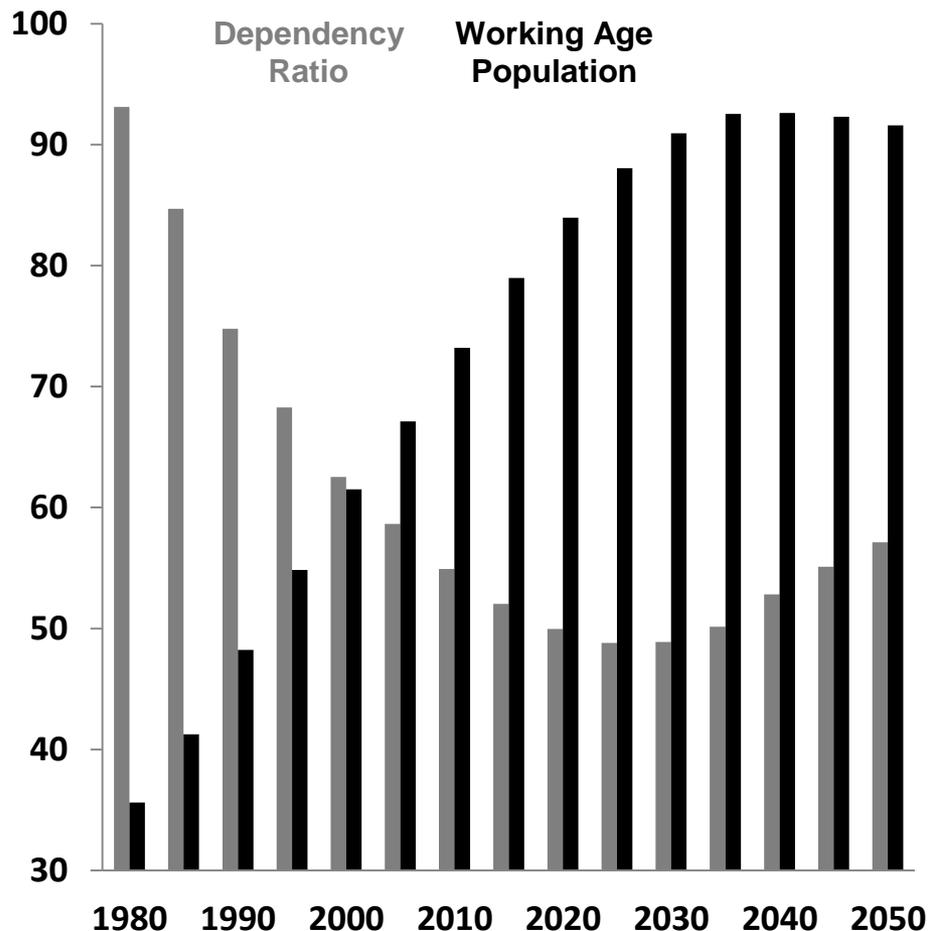
Age Cohort Distribution

% of total population



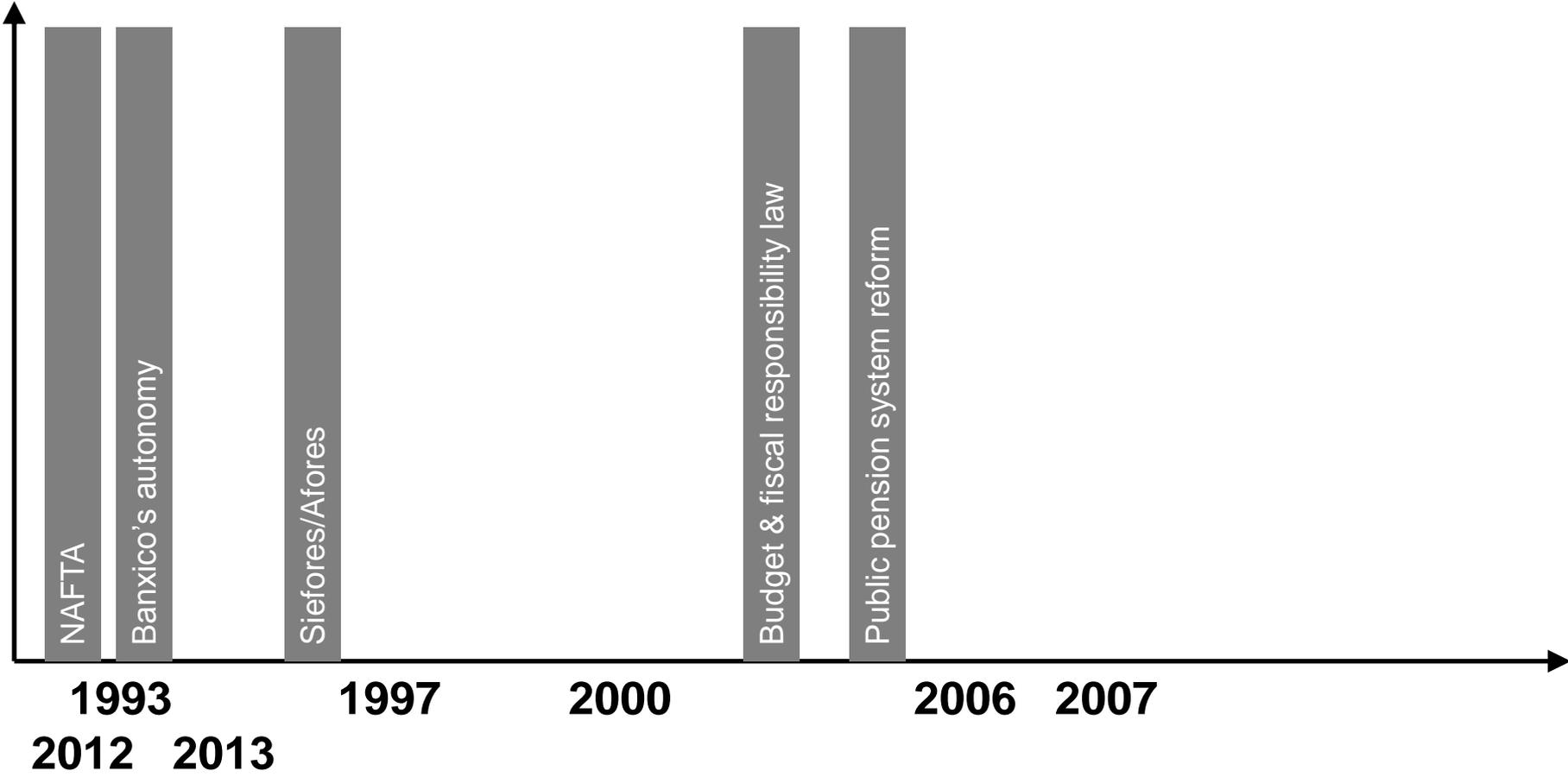
Dependency Rate and Workers

dependents / working age population and million

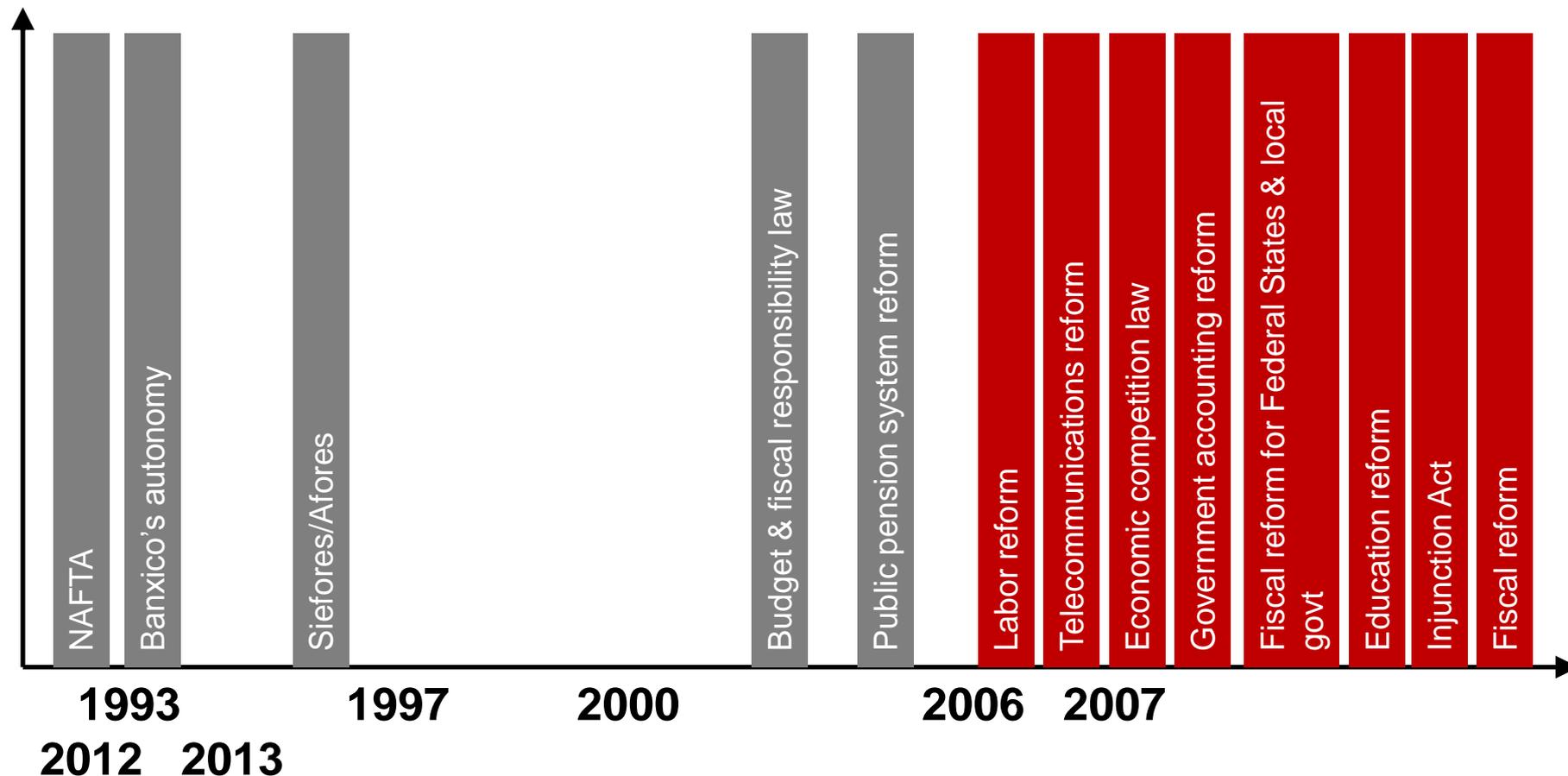


Source: CONAPO and UN

Five “deep” reforms in almost 20 years...



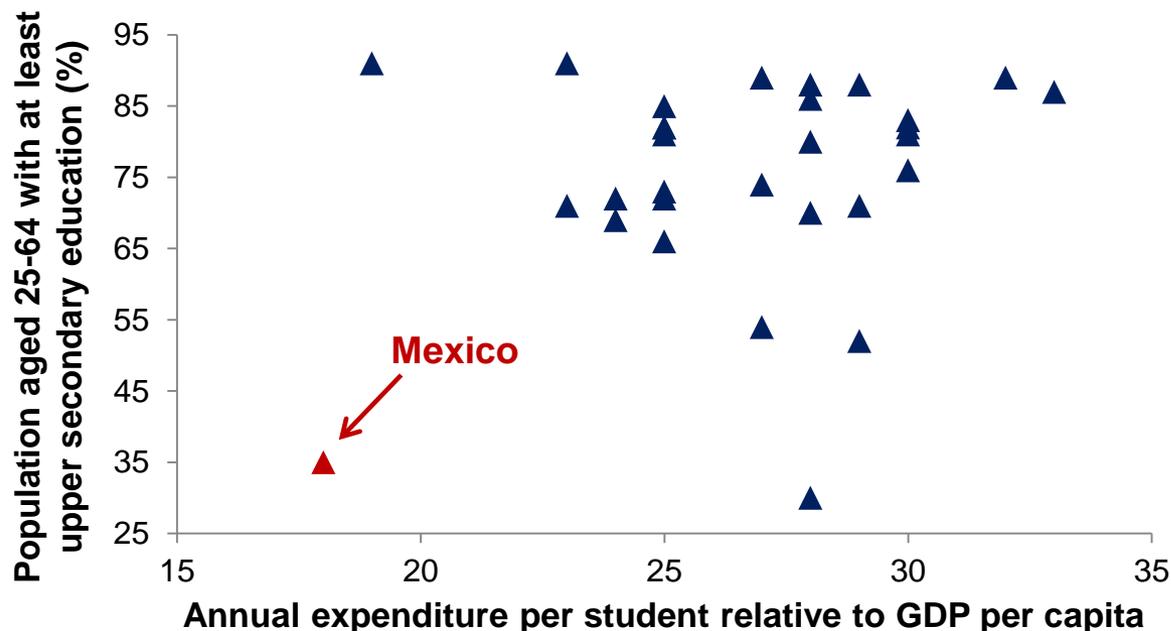
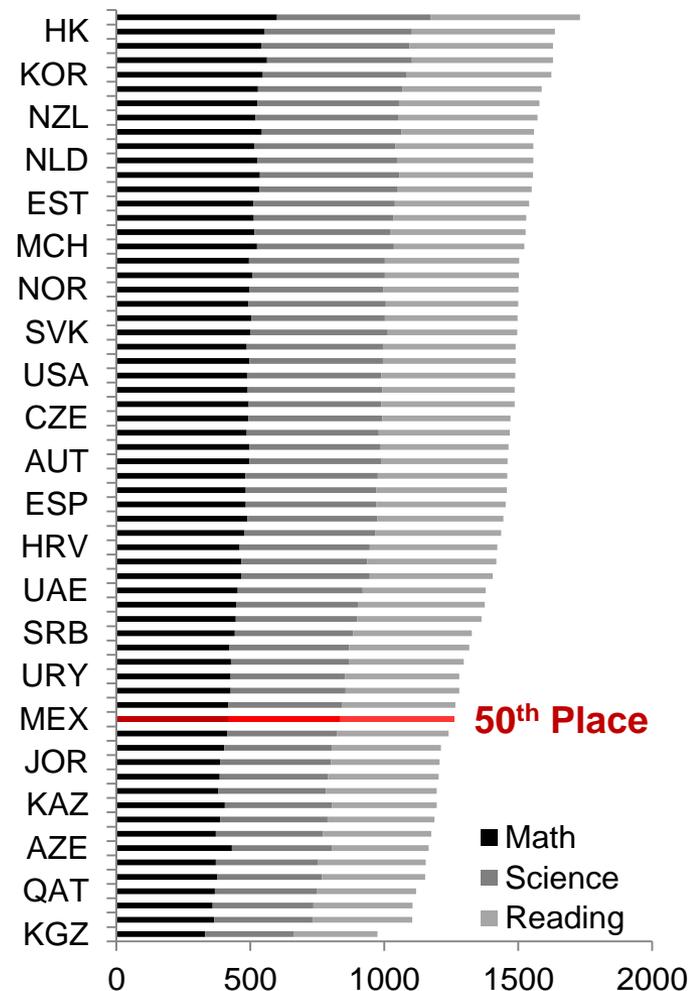
Five "deep" reforms in almost 20 years vs 8 reforms in 11 months...that could be 10 or 12 in one year



Education Reform

- ✓ 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

2009 PISA Scores

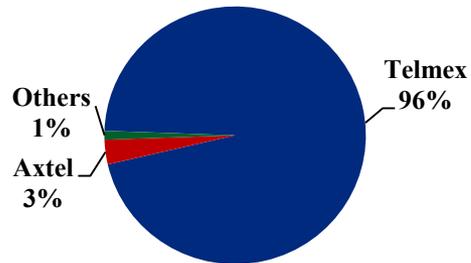


Note: Population with upper secondary education data is for 2009. Student expenditure data for 2008.
Source: OECD

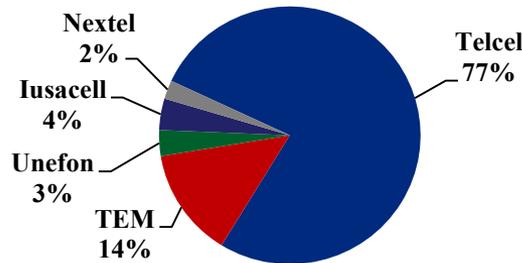
Telecommunications Reform

- ✓ 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;

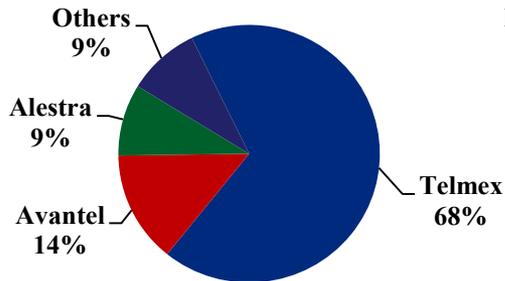
Local Services
(% of subscriber lines)



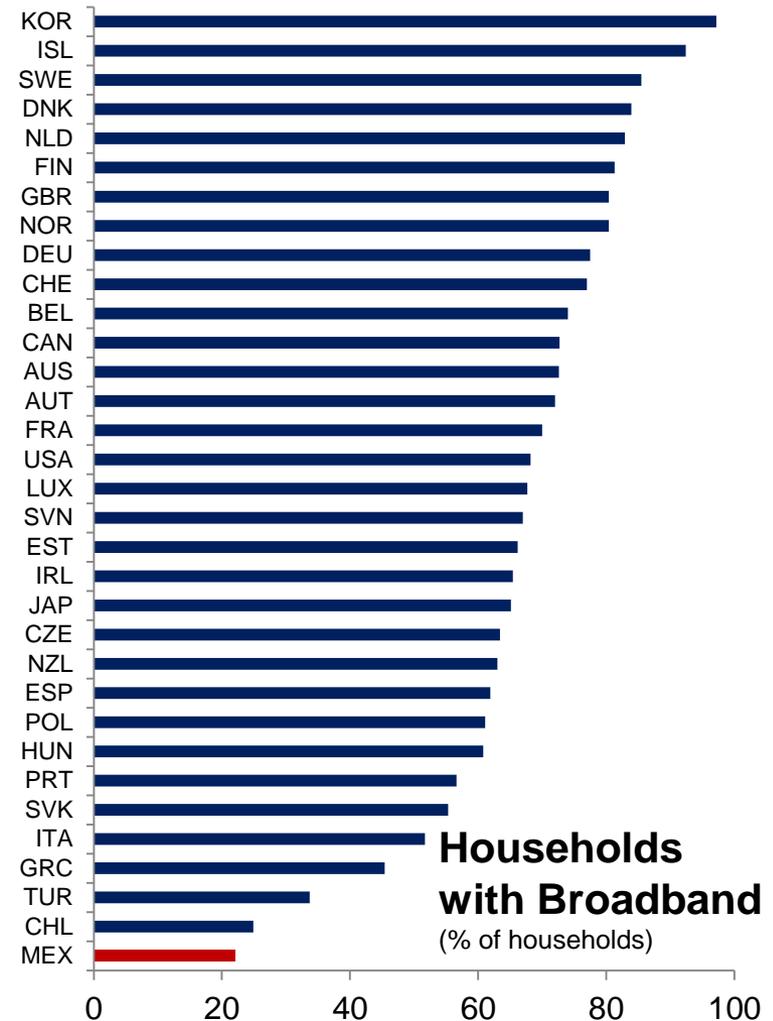
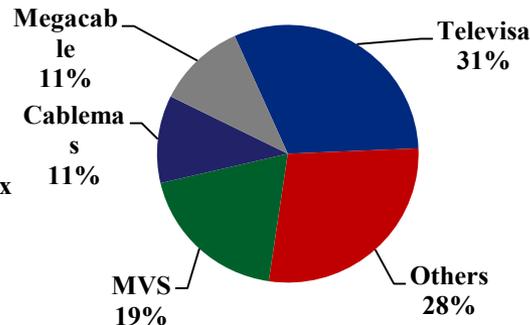
Mobile
(% of subscribers)



Data
(% of service Revenues)



Pay TV
(% of subscribers)

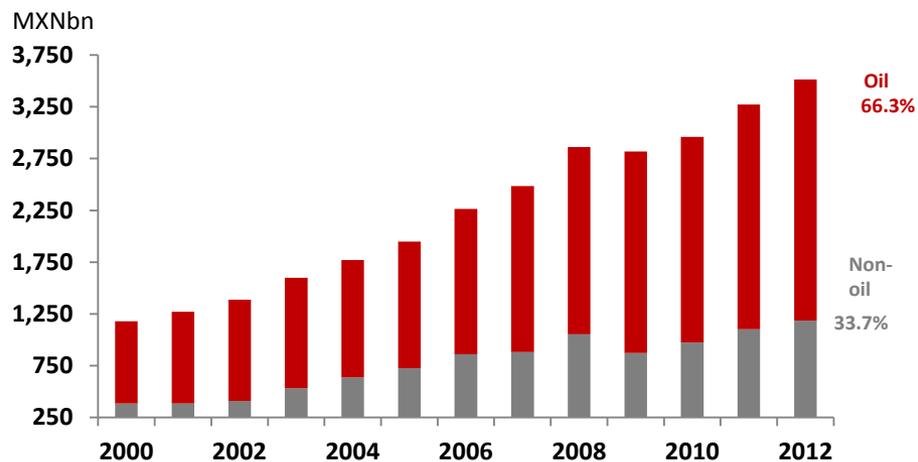


Households with Broadband
(% of households)

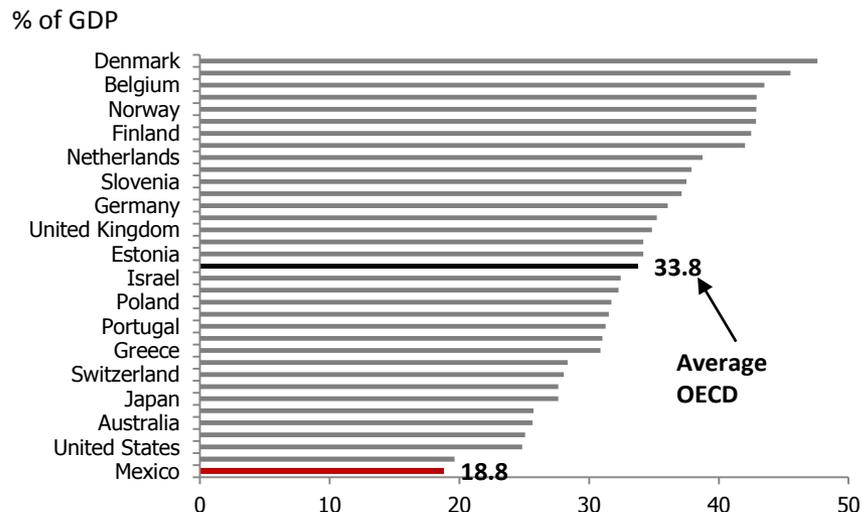
Note: Market share data is for 2005 and Broadband for 2011 or latest (see OECD Communications Outlook 2013).
Source: OECD and Arias, Javier, et al. *Policies to promote growth and economic efficiency in Mexico*. No. w16554. NBER, 2010.

Fiscal reform

Oil and non-oil revenues



Tax collection



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%

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 year
- 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

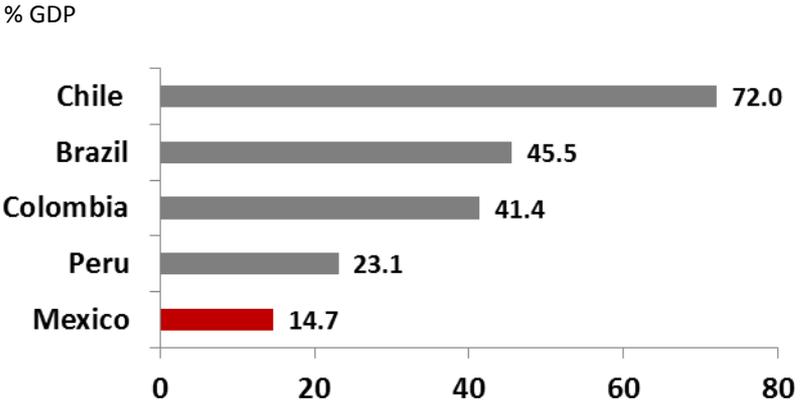
	% GDP
Total	1.4
Corporate income taxes	0.7
Personal income taxes	0.3
VAT	0.3
Non-oil excise taxes	0.2
Gasoline excise taxes	0.4
Rights	0.1
Elimination of IETU	-0.7

Source: MoF



Financial reform

Bank penetration



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

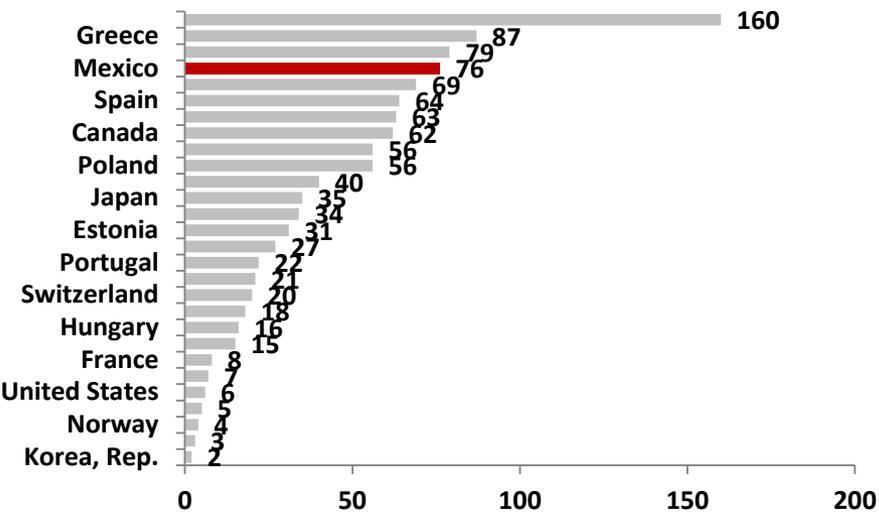
Main points: Improve enforcing contracts processes for commercial banks, guarantees programs for development banks and financial non-banks regulation

Tentative proposal: August 2013

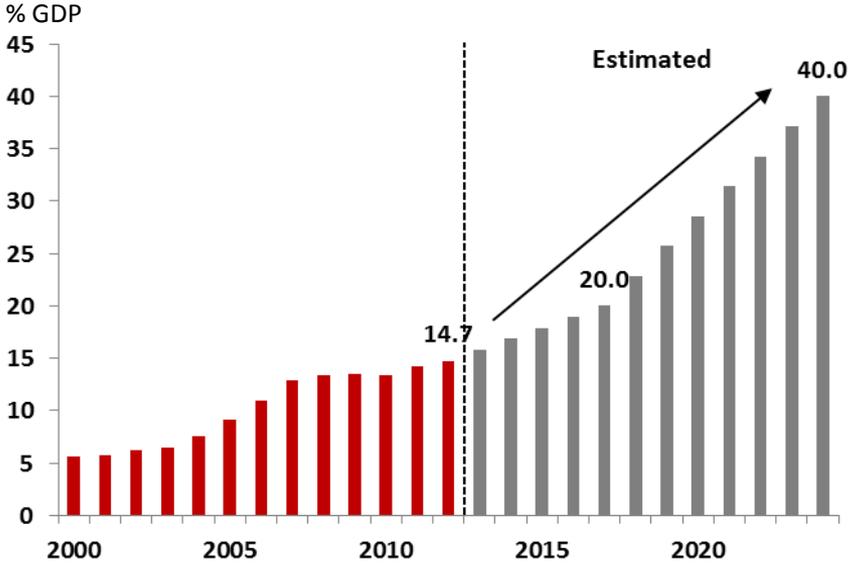
Tentative approval: December 2013

Impact of potential GDP: 0.75%

Enforcing contracts index*



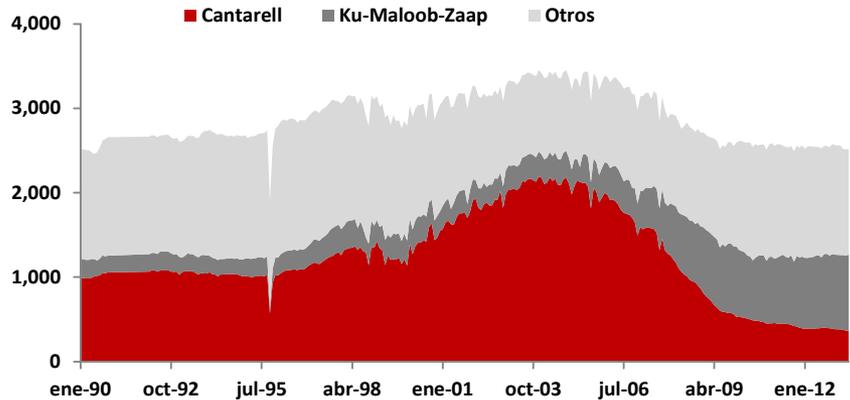
Bank penetration in Mexico



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

Energy reform

Crude oil production



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

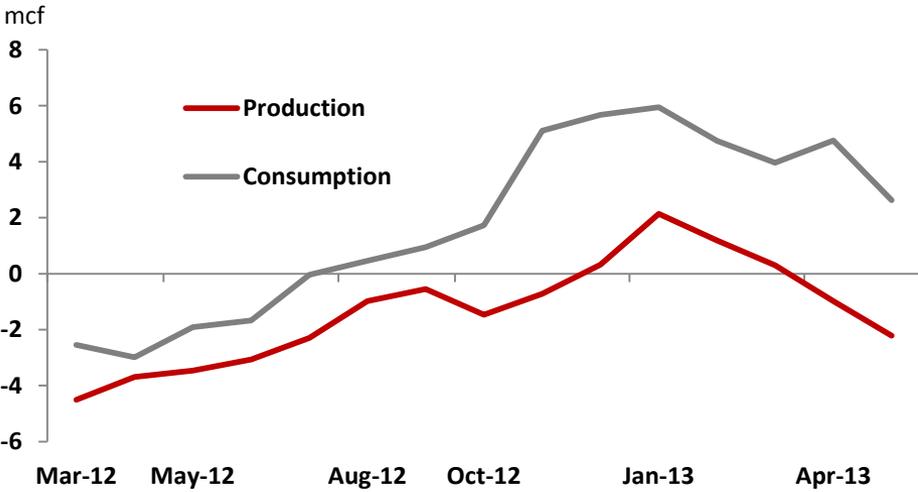
Main points: Allow private –domestic and foreign-, participation in exploration, oil production in deep seas and shale gas. Increase and make more transparent participation mechanisms in exploration and production of crude oil in shallow waters

Proposal: August 2013

Tentative approval: December 2013

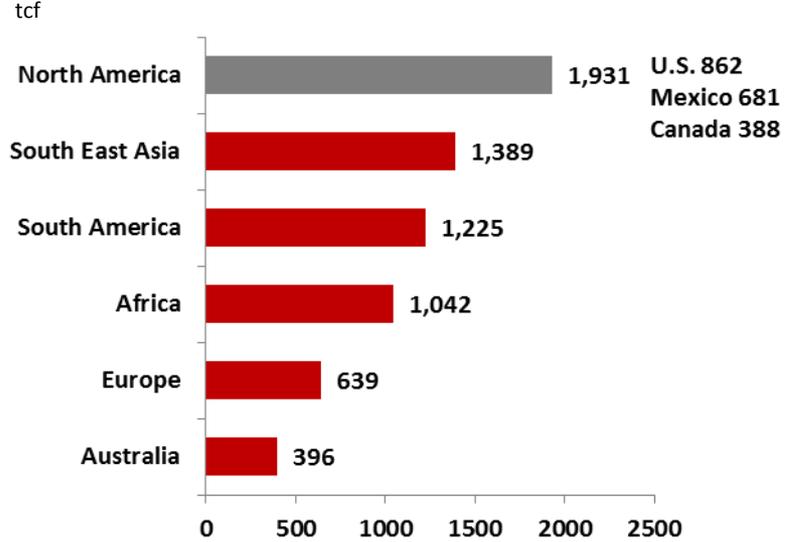
Impact on potential GDP: 1%

Output & demand of natural gas in Mexico



Source: Banorte-Ixe with data from SENER

Shale gas reserves



The challenge will be to migrate from conventional fields



Billion barrels of oil equivalent (December 31, 2012)				
		Oil and gas historical production	Total reserves	Prospective resources
	Cuencas del Sureste	45.4	24.4	20
	Tampico-Misantla	6.2	0.7	3
	Chicontepec	0.3	16.7	-
	Veracruz	0.7	0.3	2
	Burgos	2.3	0.5	3
	Deep water	-	1.7	27
	Shale	-	-	60
	Total	55	44.5	115

$\frac{3}{4}$ of prospective resources are non conventional

Main differences in parties proposals



Contracts	Concessions ⁽¹⁾	Profit-sharing ⁽²⁾	No proposal
Main changes to Pemex	Lower fiscal burden	Lower fiscal burden	Lower fiscal burden
Compensation:	Cash & barrels	Cash	N/A
Constitutional changes	Art. 25,27,28	Art. 27 y 28	No
Exploration & production sector	Open, through concessions	Open, through associations	No

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

Hydrocarbons

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.
7. Strengthening the Energy Commission and the Hydrocarbons Commission.

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.**