From reform to implementation

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Over the course of the past couple of years, Mexico has made huge strides with its structural reform programme. In point of fact, according to the OECD, Mexico has achieved more than any other major economy since the financial crisis. However, given that we are clearly not yet where we want to be, we cannot afford to be satisfied with what we have achieved thus far.

The breadth and depth of Mexico's reforms, as well as the speed with which they have been adopted, have few contemporary parallels. Taking into account the many areas involved (eleven major reforms were enacted), and the profound nature of most of those changes, one could safely say that the pace has been brisk.

It is inevitable that these structural reforms will have some short-term effect on growth, primarily through their impact on expectations and investment. Even so, it will take years to properly assess the full impact of this reform programme. Only over the course of time will we see the increases in productivity, aggressive competition, and the opening of new sectors. Structural reforms are not small-scale tools that one uses to manage aggregate demand or to tweak growth rates from quarter to quarter. We acknowledge that expectations were high, and in truth economic growth has continued. The reforms have not prevented the expansion of the Mexican economy. At the same time, however, over the past two years the economy has not improved at a faster rate than the averages observed in each of the past three decades.

Despite recent shocks and great uncertainty at a global level, Mexico is well positioned to leverage evolving conditions to accelerate growth. On the one hand, we have a very open and diversified economy that provides us with a strong export base. Moreover, through structural reforms we have addressed our most persistent limitations, such as stagnating productivity. We have done so by opening the economy to investment and increasing competition in our energy and telecoms sectors. We have improved competition policy and reformed our fiscal and financial systems, as well as our penal, labour, constitutional appeals, and education laws. We have also reformed our electoral system and our transparency (freedom of information) system.

Mexico's economy, particularly our manufacturing sector, is deeply intertwined with the economy of the United States, which is creating jobs that will sustain a broad recovery. These results are reflected in our export figures, particularly for our automotive industry. Last December, non-oil exports grew at an annual rate of 14.3 per cent. Our manufacturing exports grew even faster at 15.8 per cent, while automotive exports grew 18.6 per cent during the same period.

Even before they bear fruit in terms of extracting more barrels of petroleum from the ground, the investments derived from the forthcoming oil projects will bring a direct stimulus to our economy. There are also significant infrastructure projects in progress, particularly the redesigned Mexico City International Airport. These infrastructure projects will benefit from ready access to financing engendered by Mexico's sustained fiscal discipline, prudent macroeconomic management, and substantial involvement of the private sector.

Photo: Pemex

In the pipeline: increasing supplies of natural gas offers a significant boost to Mexico's competitiveness

In order to strengthen and secure Mexico's macroeconomic position, this year we announced a pre-emptive budget cutback. We have done so because of the importance financial stability has to us and our privileged access to deep, diverse, and liquid capital markets. In other words, we want to make sure we remain ahead of the curve, and we want to expand our fiscal buffers.

These budget cuts are consistent with the multiannual fiscal path set out in 2014: to consolidate a predictable and pre-announced fiscal policy, in order to allow all economic players to adjust smoothly and appropriately. More significantly, in the next few months we will undertake a thorough and comprehensive review of the 2016 budget to be presented in August 2015. The goal of this review is to eliminate redundant or inefficient expenditure items.

Although by any measure Mexico is an important producer and exporter of crude oil, over the past few decades we have significantly reduced our economic exposure to fluctuations in oil prices. While oil and gas production represent 5.9 per cent of GDP, our trade balance for the industry represents only 0.2 per cent of GDP. Oil revenues still account for a third of budget revenues. However, net export revenues, which are vulnerable to the international price of oil, account for less than a tenth of budget revenues (before hedging).

A sustained fall in international oil prices represents an important but manageable challenge to our public finances. Consequently, and given the adverse external conditions that Mexico faces, the Federal Government has implemented as a preventive measure a multi-year public spending adjustment. This measure aims to create additional fiscal buffers to guard against additional potential negative shocks during 2015 and beyond. The goal is to protect the Mexican economy as much as possible from such unpredictable forces as reduced global economic activity, a rise in interest rates by the US Federal Reserve, or a further drop in oil production. By employing this preventive strategy we are establishing conditions for a timely reduction in public spending, which in turn ensures that financing requirements in upcoming years remain within reason.

For 2015, the Federal Government, along with our newly independent energy companies PEMEX and CFE, has announced a joint reduction in expenditures totaling 124.3 billion pesos, or 0.7 per cent of GDP. In addition, the budget for 2016 will not be based on the inertial growth of existing programmes. Instead, the budget will be assembled via a zero-base system, meaning that every line item will be up for review, and each item will need to be justified to remain in the budget. Our goal is to ensure that it is those investment projects and programs with the greatest benefit for the population are the first to receive funding.

During this process the Mexican Government will have the support and advice of the World Bank as they conduct a comprehensive Public Expenditure Review. Such a review will enhance the efficiency of our spending policy. After more than a decade of historically high oil prices, it is time to refocus government spending by wiping the slate clean and evaluating each programme with fresh eyes.

In 2015 we expect the impact of these measures on economic growth will be marginal, and will not materially affect the range of growth we have forecast for the year. Specifically, we still anticipate that the rate of growth will fall between 3.2 and 4.2 per cent. Given that the adjustments targeted current spending and programmes and projects with low economic and social impact, any effect is expected to be mild. Up to 65 per cent of Federal Government cuts will come from current expenditures and not investment. This includes a 10 per cent reduction in salaries and wages, temporary personnel, and social communication services, as well as a realistic assessment of spending on consultancy services, cell phones, and travel expenses.

The approval of 11 structural reforms has given Mexico many opportunities for greater growth. For that to happen, though, it is necessary to implement these reforms as they are intended. Any dilution will blunt their purpose and effect. Even if we succeed in raising growth rates, however, this will not be enough for Mexico. We need to reestablish trust in our authorities and ensure that our democratic institutions are complemented by a strong rule of law. We must restore trust in the political process as well as in the ability of the federal government to implement the reforms in a fair and efficient manner. We need to step up, to face new challenges, as well as restore faith in our institutions. This is key if we are to follow confidently in the path we have set for ourselves towards higher growth and development.

Mexico will safeguard its established and well-earned macroeconomic stability. We will fully implement the reform agenda that has been approved by Congress. We understand that structural reforms, even if they are enough to increase growth to the levels we require, are not enough. This administration is fully committed to strengthening the rule of law, increasing transparency, and fighting corruption. F

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Preparing for take-off: an artist's impression of the new Mexico City International Airport

Photo: Foster + Partners