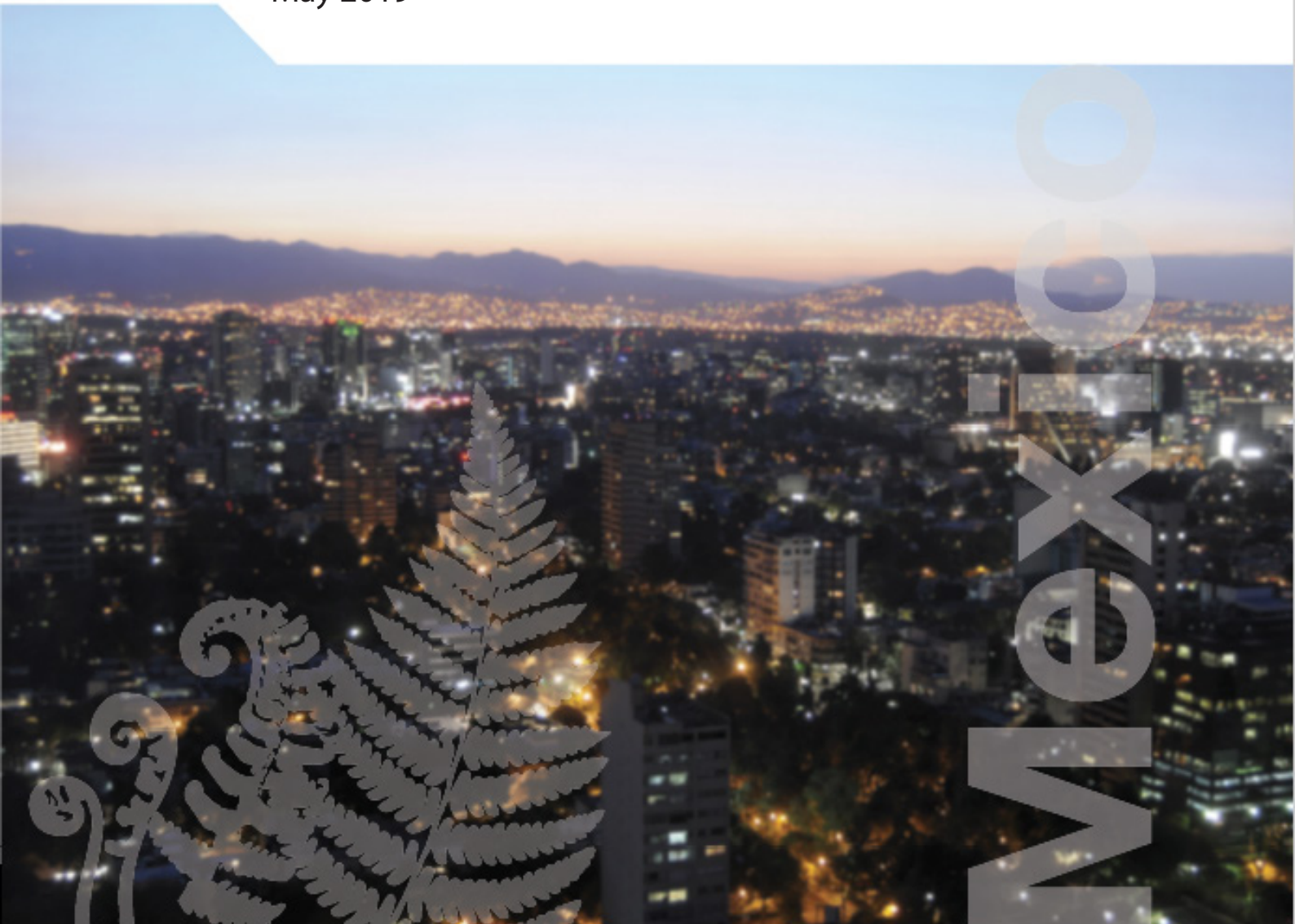




OECD Economic Surveys **MEXICO**

Executive Summary

May 2019



- **Moderate growth is underpinned by a strong macroeconomic framework**
- **The tax and transfer system could support growth and equity more firmly**
- **Strengthening the quality of institutions**
- **Unleashing productivity and inclusiveness**

Key recommendations

Maintaining a strong macroeconomic framework and finding resources for more equitable growth

- Maintain a prudent fiscal stance to keep the debt-to-GDP ratio stable and consider lowering it over the medium-term.
- Maintain the current monetary policy stance to curb inflation.
- Accelerate the current initiatives to enhance financial inclusion, financial literacy and competition. Monitor outcomes.
- Move towards making all government transfers to households through bank accounts or electronic means.
- Develop a comprehensive tax reform for implementation in the medium term.
- Broaden the VAT base by cutting exemptions and abolishing reduced rates while compensating the poor with targeted subsidies.
- Increase the progressivity of personal income tax by lowering the income threshold for the top rate and further cut back tax allowances or convert them into tax credits.
- Build a nationwide property register to make more use of recurrent taxes on immovable property.
- Continue to reduce duplication of social programmes, beneficiary overlaps and expand coverage to the poor not receiving social benefits.
- Establish a non-partisan, independent and adequately resourced fiscal council, along the principles defined by the OECD.
- Revise the Ley de Coordinación Fiscal to redefine and clarify responsibilities of public service delivery across the three levels of government and cut overlaps. Build capacity and professionalise the civil service at the state and municipal levels.
- Further strengthen the tax administration through adequate staffing and resourcing and improve technological capabilities.
- Link the tax administration (SAT) and the social security databases to improve tax surveillance and compliance.

Strengthening inclusive growth

- Expand access to good quality, affordable childcare. Increase the length of the pre-school day for three- to five-year-olds.
- Reduce high female drop-out rates in education.
- Complete the implementation of the National and Local Anticorruption Systems reforms and monitor the results. If needed, consider introducing a specialist, independent anticorruption agency that takes into account the federal structure of the government.
- Continue efforts to reduce crime and impunity.
- Ensure that the competition authorities and sector regulators have adequate resourcing and independence to carry out their mandates effectively.
- Lower social security contributions for low wage earners. Step up enforcement.
- Implement a coordinated approach to reduce informality, comprising lower administrative burdens to doing business, including tax compliance costs, and reduced dismissal costs while stepping up social protection.
- Lead by example and progressively reduce the number of informal workers in the public sector.
- Raise the quality and coverage of early childhood education and care programmes and delink them from parents' labour market status.
- Continue to expand VET coverage, assess the results of the internship programmes and encourage female participation.
- Allow and encourage municipalities to create joint metropolitan governance arrangements on their own initiative, in particular metropolitan transport authorities.
- Invest in integrated public transport systems focusing on improving access in low-income areas.
- Raise the carbon tax gradually and predictably, eliminate exemptions and reduced rates and compensate the poor. Resume long-term auctions to encourage the supply of renewable energy, linking the remuneration of supply to market conditions.

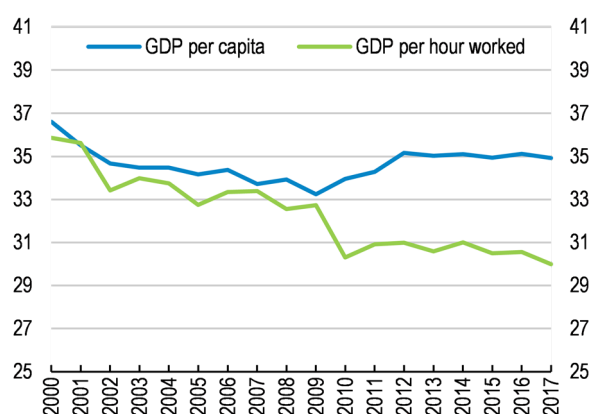
Moderate growth is underpinned by a strong macroeconomic framework

Commitment to fiscal targets, sound debt management, a flexible exchange rate and an appropriate monetary policy stance have supported moderate growth in spite of several headwinds in recent years.

Integration into global value chains is driving robust export growth while a recovery in real wages, strong remittances and credit growth have supported consumption. Declining oil production continues to be a drag on the economy and fiscal revenues. Investment remains subdued, reflecting policy uncertainty domestically as well as abroad, but also fiscal consolidation, which has helped to halt the rise in public debt against a generally weak redistributive role of fiscal policy.

Moderate growth has not improved relative living standards. This reflects low productivity growth, in turn influenced by poor educational outcomes, weak rule of law, obstacles to competition and widespread informality. Many of the recent reforms to open up the economy are yet to bear fruit, as their effects take time to materialise, implementation is still ongoing and institutional reform is lagging behind.

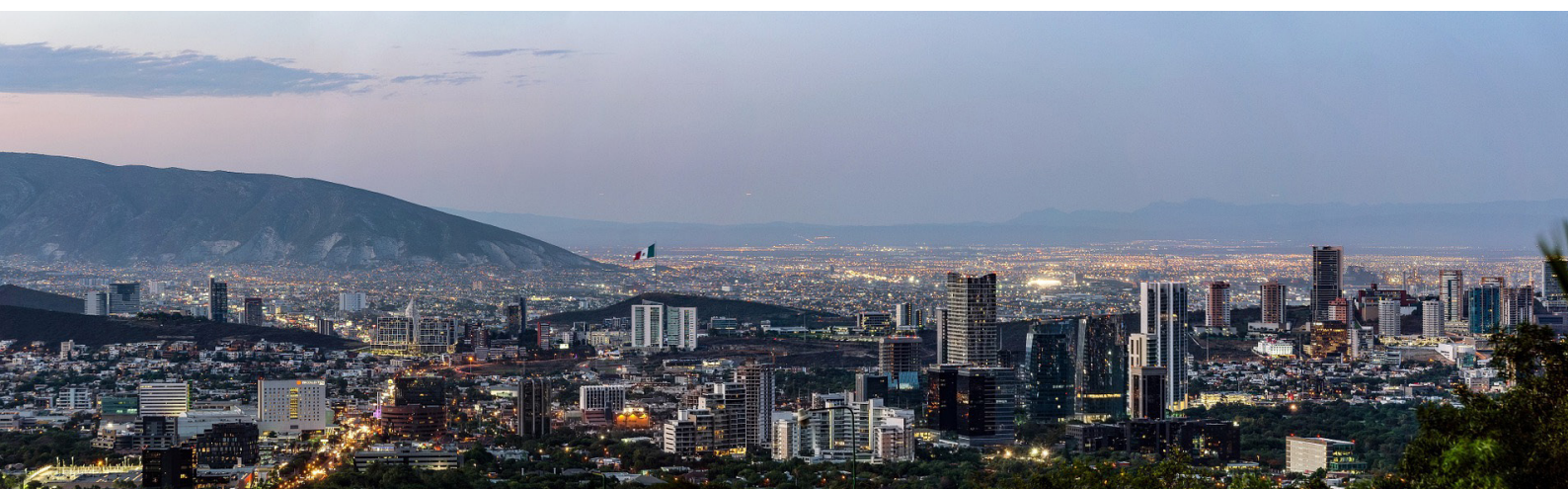
Figure A. Low productivity growth is stalling convergence of living standards
% of upper half OECD



Source: OECD Productivity database

Table A. Growth will strengthen moderately

	2017	2018	2019	2020
	% change, volume (2013 prices)			
GDP at market prices	2.3	2.0	1.6	2.0
Private consumption	3.4	2.2	1.3	2.2
Government consumption	1.0	1.4	-0.6	0.3
Gross fixed capital formation	-1.6	0.6	-1.8	2.2
Exports of goods and services	4.0	5.7	2.9	4.9
Imports of goods and services	6.7	6.2	4.2	4.5
Consumer price index	6.0	4.9	3.8	3.6
Current account balance (% of GDP)	-1.7	-1.8	-1.9	-1.8



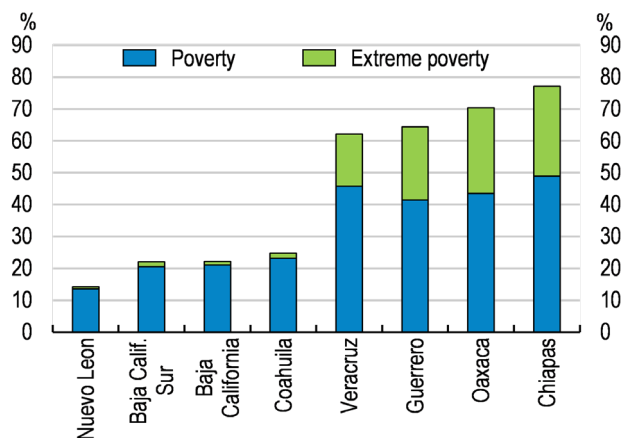


A growing divide between a more productive and modern economy in the north and centre of the country and a more traditional economy in the south reinforces inequalities. Despite increased social spending, poverty and inequalities loom large. Greater equality of opportunities for women and indigenous people is needed to address high disparities in well-being.

Growth will strengthen moderately in the medium term. Investment will recover on the back of planned infrastructure projects complemented with institutions conducive to private investment. Domestic consumption will be supported by increases in the minimum wage, continued low unemployment and strong remittances. Exports will keep supporting the economy, albeit at a lower rate.

The outlook is subject to sizeable risks. Fast implementation of investment plans to boost oil production would raise exports and lower the energy trade deficit, but the goal of boosting oil production by the projected magnitude will likely require additional private investment. A firm commitment to fighting crime and widespread corruption could create a more enabling business environment.

Figure B. Poverty and inequalities across regions remain high



Source: CONEVAL.

On the other hand, policy uncertainty, also in the context of the need for all parties to ratify the new trade deal between Canada, Mexico and the United States, a slowdown in the global economy and renewed trade tensions would hinder exports and depress private investment.

The tax and transfer system could support growth and equity more firmly

The fiscal stance is appropriate given the high debt level. Over time, debt should be put on a declining path as fiscal space is increased with more revenues.

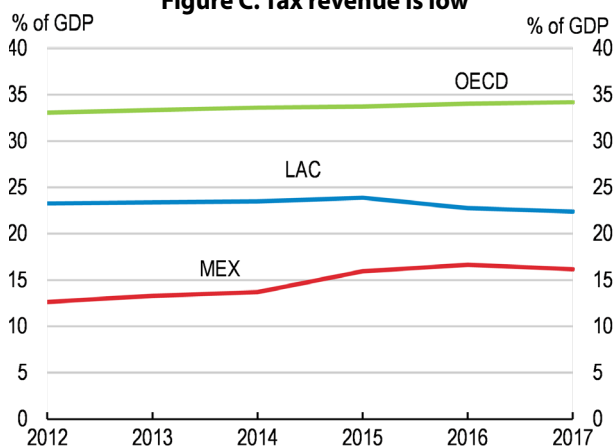
Tax collection should be raised over time. The 2014 tax reform raised non-oil revenues but tax revenue is still lower than in OECD and LAC countries on average. Furthermore, the reform did little to reduce disposable income inequality. Overall low tax collection limits social spending and infrastructure investment.

There is room to raise the tax-to-GDP ratio in an inclusive way, by broadening the tax base, and continuing to fight tax evasion and avoidance, including by reinforcing federal- and state-level tax administrations. Additional VAT revenue could be collected by applying the standard rate more generally, while implementing subsidies targeting the poor. The threshold for the top marginal personal income tax rate is relatively high and many exemptions and deductions benefit those with higher incomes.

Fiscal federal relations affect the quality and efficiency of public service delivery. The current fiscal equalisation mechanisms have not promoted regional convergence nor reduced inequalities across states. Clarifying responsibilities across levels of government and achieving a better match between service delivery and tax collection would improve accountability at the state and municipal level and raise tax collection.

Social programmes are too numerous and do not always reach the poorest. Making use of the beneficiary database (SISI) and matching it with the social census could detect non-entitlement, beneficiary overlaps, material deprivations at the household level and duplications in social programmes. This would free more resources to attend to the needs of the most vulnerable. Reducing fragmentation in the delivery of health services and pension systems would improve service quality and equity, as well as fiscal sustainability.

Figure C. Tax revenue is low



Source: OECD Global Revenue Statistics Database.



Strengthening the quality of institutions

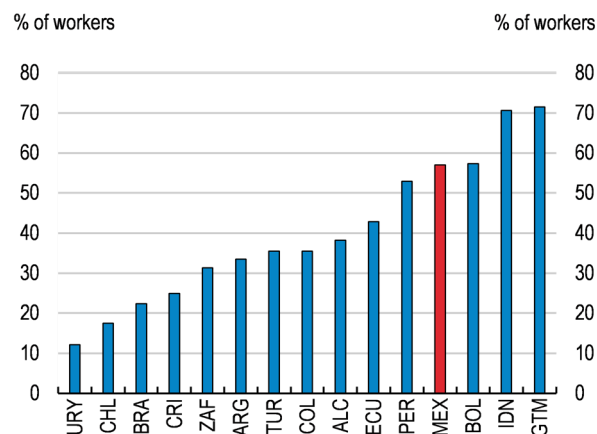
The rule of law and quality of institutions in Mexico is low and has deteriorated, disproportionately hurting the poor.

Impunity levels are extremely high, violent crime continues to grow and control of corruption is weak compared not only with OECD countries, but also Latin American and Asian economies. The cost of crime is high and its incidence varies greatly across regions, widening existing regional disparities in well-being.

Improving institutional quality would have the largest growth benefits among all structural reforms and would increase the impact of all other policy reforms. Corruption affects the business environment, public spending efficiency and trust in the public sector. The implementation of the National Anticorruption and Local Anticorruption Systems should be completed.

Recent reforms to create independent competition authorities and sector regulators have been positive. The autonomy of these entities should be maintained and resourcing levels should allow them to undertake their mandates effectively and continue to build their capacity.

Figure D. Informality is stubbornly high



Source: SEDLAC and INEGI.



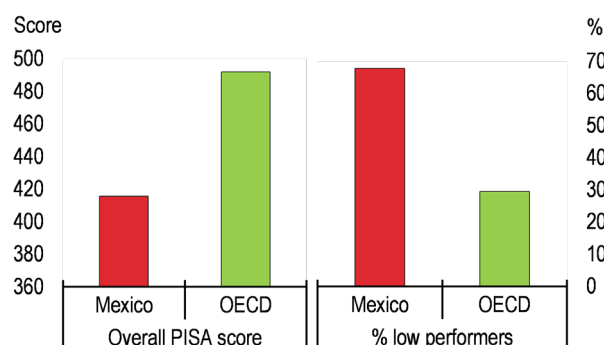
Unleashing productivity and inclusiveness

Mexico's persistently high informality constrains productivity growth and fiscal capacity to provide public benefits and redistribute.

It also feeds inequality of incomes and opportunities. Informality is affected by many complex factors. The expansion of universal protection associated with low benefits of formalisation reduces its attractiveness. Segmentation in the provision of social services according to labour market status should be progressively reduced while benefits associated with formalisation should be strengthened. Reducing the high and uncertain costs of dismissing a formal worker and introducing an unemployment insurance scheme would reduce disincentives to formal job creation while better addressing the personal costs of job loss. Enforcement could be improved by integrating the tax and social security administrations. Social security contributions of low-skilled workers could be reduced.

While education services have expanded, poor educational outcomes hamper productivity growth, contribute to persistent inequalities and job informality. Education spending should be re-focused on pre-primary, primary and secondary education and more should be done to increase the capacity of schools in poor neighbourhoods and to support children from disadvantaged backgrounds. Increasing the quality of early childhood care and access among low-coverage regions and children from disadvantaged backgrounds would be a cost-effective way to boost educational outcomes, and ultimately productivity, while also reducing inequality. It would also increase women's labour market participation, which is one of the lowest in the OECD.

Figure E. PISA outcomes are poor



Source: OECD PISA database.

School infrastructure and pedagogical material could be improved. Given the high rates of youth not in employment, education or training, particularly among women, the government's plans for a large internship programme are welcome. The programme should ensure strong female participation, and its results in generating stable and formal jobs should be evaluated with a view to further expanding them into a vocational educational and training programme.

Integrating environmental concerns into policy making has much potential to improve economic and environmental outcomes. Reforms in the governance of the large metropolitan areas would enable local governments to plan land use, public transport and housing in an integrated manner, boosting productivity and lowering congestion and air pollution, which affects low-income households the most.

MEXICO

Mexico's robust macroeconomic policy framework has supported moderate growth despite several headwinds in recent years. However, low productivity growth has hindered Mexico's convergence to higher-income OECD countries and inequalities remain high. These factors call for a renewed strategy to boost productivity and inclusiveness. Rising crime and insecurity are negatively affecting economic activity and citizens' wellbeing, particularly the underprivileged and women. Strengthening institutional quality is a priority. Improving the weak rule of law will also facilitate the effective implementation of policy initiatives in other areas. In spite of recent achievements, tax revenues remain low and fiscal policy has little redistributive impact. In the near term, improving the efficiency of tax collection and spending will allow the public debt-to-GDP ratio to stabilise and provide some room for greater social and infrastructure spending. In the medium term, raising tax revenues and modifying the tax mix will allow reductions in public debt, create further fiscal space and increase progressivity. Reducing high informality will require coordinated actions in enforcement, taxation, business and labour regulations and the social safety net to better align incentives to formalise and drive resources towards more productive (formal) firms. Increasing educational outcomes for all will increase equality of opportunities and build the foundations for higher productivity. Raising access to quality early childhood education and care will also encourage greater female labour market participation. Improving urban planning and transportation would raise the productivity potential of cities and improve environmental outcomes.

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