“Peter Pan” to Powerhouse: Mexico, 2015-2040

Mexico faces many obstacles...

- Capital is not Deep Enough
- Inefficient Labor Markets
- Manufacturing Dependence on the US
- Low Labor Productivity
- Contracts not Enforced
- Monopolies & Oligopolies in Key Sectors
- Specialization in Manufacturing
- Inadequate infrastructure
- Corruption
- Lack of Rule of Law
- Crime and Violence
- Failing Education System
...but history suggests Mexico has great potential for growth, which can be unleashed with reforms in 8 key areas…

**GDP per Capita Evolution Over Time**

Source: World Bank, FRED, OECD

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**Mexican Miracle (1945-1970)**
- Education reforms
- Relaxation in import of capital goods
- Increased Infrastructure Spending

**Oil Price Boom**

**The Lost Decade (1980-1990)**
- Oil dependence
- High leverage
- MXN 500% devaluation

**Oil Price Normalization**

**NAFTA**

**TFP Decline (1980-2010)**
- Low savings and investment rate
- Input-driven growth

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**Radical Reforms (2012-)**
- Kickstart and get out of “Middle Income Trap”

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**Growth Accounting**

Source: World Bank, FRED, OECD

<table>
<thead>
<tr>
<th>Period</th>
<th>Y/N</th>
<th>αK/L</th>
<th>L/N</th>
<th>TFP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961-1969</td>
<td>3.17</td>
<td>1.43</td>
<td>-0.24</td>
<td>1.99</td>
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<tr>
<td>1970-1979</td>
<td>3.27</td>
<td>0.30</td>
<td>2.24</td>
<td>0.73</td>
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<tr>
<td>1980-1989</td>
<td>-1.14</td>
<td>0.10</td>
<td>1.38</td>
<td>-2.62</td>
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<tr>
<td>1990-1999</td>
<td>0.83</td>
<td>0.24</td>
<td>0.79</td>
<td>-0.20</td>
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<tr>
<td>2000-2014</td>
<td>1.62</td>
<td>1.16</td>
<td>0.28</td>
<td>0.18</td>
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</table>
An improved education system coupled with a more efficient labor market will support sustained economic growth.

**Education**

- Teacher Compensation and Investment
- PISA Test Results

**Labor Efficiency**

- Labor Productivity
- GDP per hour worked as % of USA (USA=100)

**Reforms**

- Evaluations of teachers
- Autonomous regulators

- Increase flexibility with the Federal Labor Law
- Challenge union bosses
- Easier to hire and fire, and to settle disputes

Source: OECD
Key sectors have are controlled by few big firms increasing input costs for the economy, while an increasing share of SMEs lost 6.5% in productivity.

### Competitive Landscape

**Broadband Prices**

- Mexico
- Chile
- United States
- Poland
- Britain
- Czech Rep.
- South Korea
- Japan

<table>
<thead>
<tr>
<th>Broadband prices (Sep/2012 $/Mbps)</th>
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<tbody>
<tr>
<td>0.0</td>
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<tr>
<td>0.5</td>
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<tr>
<td>1.0</td>
</tr>
<tr>
<td>1.5</td>
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<tr>
<td>2.0</td>
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</tbody>
</table>

### Key Industries with few competitors

- PEMEX
- CFE
- América Móvil
- TELMEX
- Televisa

### Business Informality

**The Peter Pan System at work**

- Greece: 96.9%
- Mexico: 95.5%
- France: 87.8%
- Spain: 83.0%
- Portugal: 82.3%
- United Kingdom: 77.8%
- Brazil: 64.6%
- United States: 59.2%
- Ireland: 55.3%

% of Manufacturing Businesses with 1-9 employees

<table>
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<tbody>
<tr>
<td>Greece</td>
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<tr>
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<td>United States</td>
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<tr>
<td>Ireland</td>
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</tbody>
</table>

### SMEs with Low Access to Credit

- SME %
  - 13.0%
  - 12.3%
  - 12.0%
  - 13.0%
  - 13.3%
  - 16.1%

+11.4%

Business Loans (MXN bn.)

2007: 0
2008: 200
2009: 400
2010: 600
2011: 800
2012: 1000

### Reforms

- New competition authorities
- Ending monopolies
- Increased competitiveness

### Source:

OECD Entrepreneurship at a Glance, The Economist
Upcoming FTAs should diversify Mexico’s output while spending in infrastructure will surge

5 Trade

U.S. Share of Exports from Mexico

- **1994**: 17% US, 83% Non-US
- **2004**: 14% US, 86% Non-US
- **2014**: 20% US, 80% Non-US

Source: WEF, IMD, PwC, Gridlines Summer 2013, Mexican Economic Secretariat

6 Infrastructure

- **69**: out of 133 in the WEF infrastructure competitiveness index
- **47**: out of 57 in IMD’s World Competitiveness Index

- **Mexico’s Trade Deficit**

- **Projected Infrastructure Spending**

- **Reforms**
  - Pacific Alliance
  - Trans Pacific Partnership, invited by U.S.

- **Reforms**
  - Significant increase in spending (already being implemented across sectors)

Source: WEF, IMD, PwC, Gridlines Summer 2013, Mexican Economic Secretariat
But... How should Mexicans reconcile the recent corruption scandals and weak law enforcement?

**Crime and Rule of Law**

- 95% of the offenses are not solved or punished
- 80% of homicides are not solved or punished

**Reforms**

- Small claims court to enforce contracts
- Unified national code for criminal proceedings
- More police

**Governance and Corruption**

- Anti-corruption authority
- Administrative sanctions on officials
- New rules to incentivize officials

Source: Vision for Mexico
Mexico is at an inflection point and its government has initiated reforms aimed at boosting the economy’s productivity and making it more competitive.

Solow Model GDP per Capita Projection
Source: World Bank, FRED, OECD, own calculations

Note:
1: A regression of TFP growth on the Rule of Law Index (CFS and WEF) and the Distance to Frontier (World Bank Doing Business) on 26 upper middle income countries was performed to estimate the reform effects. Substantial improvement on business environment, infrastructure and labor force in 2016-2019 (represented by DFT) and in governance and rule of law (RLI) in 2017-2020.
Conclusion and Recommendation

• **Probability of Success**
  – Government has failed many times in the past
  – Current administration’s reforms are sincere and thorough

• **Our thoughts**
  – Even the progress to date is worth investment
  – Invest in Mexico now given the reform to date & trajectory of future reform

“Deserve what you dream”
Octavio Paz
Mexican Nobel Literature Laureate 1990