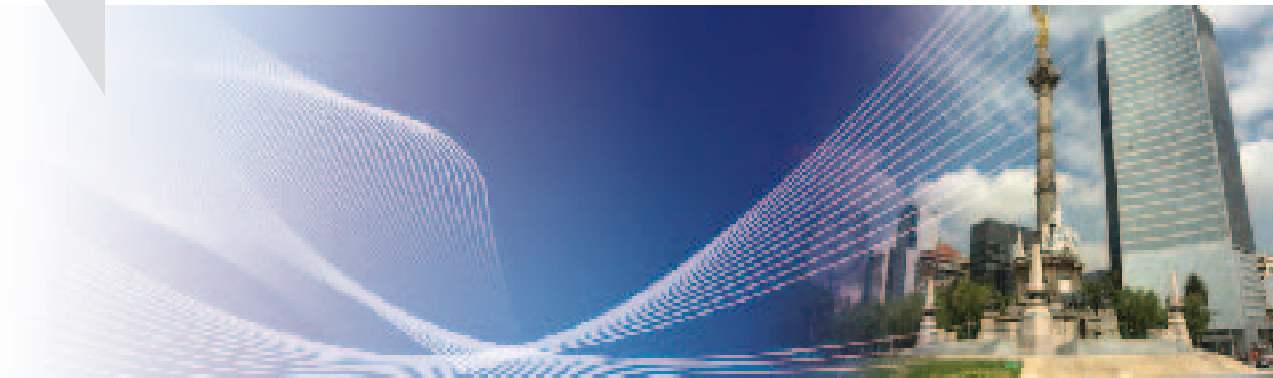




OECD Perspectives: Mexico Key Policies for Sustainable Development



October 2010



Contents

Preface	3
The Economy	4
Labour Market	7
Regulatory Policy	11
Budgeting and public-sector efficiency	12
Tax System	15
Competition	17
Inequality	21
Education	24
Innovation, and Information and Communication Technologies (ICTs)	28
Environment and Green Growth	32
Health	36





Preface

Following one of the steepest downturns among OECD countries, involving a 6.6% GDP contraction in 2009 and a substantial increase in unemployment and informality, the Mexican economy is now making an export-led recovery. GDP growth for 2010 is forecast at around 5%, one of the highest rates in the OECD.

Rather than a “return to normalcy”, however, this recovery represents an occasion for change – an opportunity to deal with the economy’s vulnerabilities. Although Mexico has made very important progress in terms of macroeconomic stability, monetary policy and fiscal transparency, it has so far been unable to generate strong endogenous growth based on a vibrant domestic market and a competitive economy. Its labour productivity is the lowest of all OECD countries; its competitiveness is eroding; and other emerging economies are overtaking it in the race towards the knowledge economy. Mexico still has major structural challenges requiring fundamental reform.

The current juncture requires a programme for change, to equip the country with a new legislative and policy framework that promotes stronger, cleaner and more equitable economic growth. This means a robust tax system that helps reduce disparities; a budget focused on medium- and long-term results; a labour market that is efficient, inclusive and in tune with future needs; a cutting-edge educational system; a framework of policies and incentives that promotes competition along with good corporate governance and innovation; green growth that fosters a new ecological culture; and a comprehensive, high-quality health system that is sustainable.

The present document addresses these and other challenges that Mexico will have to face in the coming years; and it makes a number of recommendations based on international experience. Mexico has major strengths with which to successfully meet these challenges: a vibrant democracy; a legislature that is increasingly convinced of the need for reform; a banking sector that is stronger and more stable than its counterparts in many OECD countries; and a young population that is eager for new opportunities. The current administration is promoting ambitious labour-market reforms and other measures to promote competition; and these hold out the promise of improvements in productivity, competitiveness and jobs.

The OECD will continue to support Mexico in this endeavour, working hard to evaluate and compare its public policies, and helping it to find the best solutions to present and future challenges. We hope that this collection of analyses and recommendations will contribute towards the design of policies leading to a more prosperous, balanced and inclusive future for all Mexican people.

Angel Gurría
Secretary-General



The Economy

Following the deepest recession in decades, the Mexican economy has embarked on an export-led recovery. Economic activity has increased sharply since mid-2009, helped along by stronger foreign demand for Mexican exports, a revival of manufacturing activity and business investment. The economy has also benefited from the re-building of inventories and higher oil prices. Mexico's recovery is likely to fade, however, as the U.S. recovery falters in the second half of 2010, since domestic demand is not sufficiently robust to pick up the slack left by slowing exports.

Macroeconomic outlook

Nonetheless, the recovery is expected to continue, and growth could be close to 5% in 2010. Private consumption and investment should strengthen as unemployment declines and business confidence recovers. With the export expansion expected to taper off through the second half of 2010 and into 2011, GDP growth may slow to less than 4% in the latter year. The current account deficit can be expected to widen, with import growth strengthening along with domestic demand.

Inflation in Mexico has declined faster than predicted, undershooting expectations for several months in a row. It is expected to rise temporarily in the second half of 2010, reflecting administrative price increases and the lagged effects of recent exchange-rate movements. Thereafter it should resume its downward trend in 2011, given the persistence of substantial unused capacities and the ongoing fiscal consolidation, and remain within the target range set by Banco de México in 2011 and 2012 as an annual average. This would make it possible for the central bank to keep policy interest rates around their current levels to help consolidate the recovery.

Fiscal policy

Fiscal consolidation is under way, with both expenditure cuts and tax hikes implemented in 2010. The public-sector borrowing requirement (a broad measure of the budget deficit that includes PEMEX investment but excludes non-recurring revenue) is expected to improve in 2010 and 2011, thanks to the budgetary consolidation measures, the cyclical recovery of taxable income and rising oil prices. Fiscal discipline is needed to compensate for the long-run decline in revenues attributable to falling oil production. In the absence of measures to reduce budgetary dependence on oil revenues, there is a risk of adverse market reactions. Should oil prices turn out higher than assumed in the budget, the resulting short-term revenue surpluses should be invested in oil stabilisation funds to shield the budget against future price fluctuations.

In the medium term, a base-broadening tax reform will need to include measures to increase the efficiency of public spending, limit or ideally eliminate energy subsidies and improve tax collection, while strengthening incentives for businesses and workers to operate in the formal sector. VAT exemptions for food and medicine, as well as the in-work tax credit, should be reviewed, since there are more effective and economical ways than these measures to redistribute income. Energy subsidies are costly; they distort economic behaviour and are harmful to the environment. At a time when Mexico has decided to embrace global efforts to mitigate climate change by reducing its GHG emissions, such subsidies should gradually be replaced by transfers that more effectively target the poor.

Greater reliance on indirect taxes could help to extend taxation of the informal sector. In addition, Mexico will need to reduce the cost to workers of entering the formal sector, while increasing the associated benefits. Among other things, Mexico could consider reducing social contributions for the lowest-paid workers in particular, or it could finance more of social security from general tax revenues, and less from contributions levied on wages. The regulatory hurdles and costs that individuals face when moving into the formal sector could be reduced further, while improving the quality of pensions and health services to make the benefits of



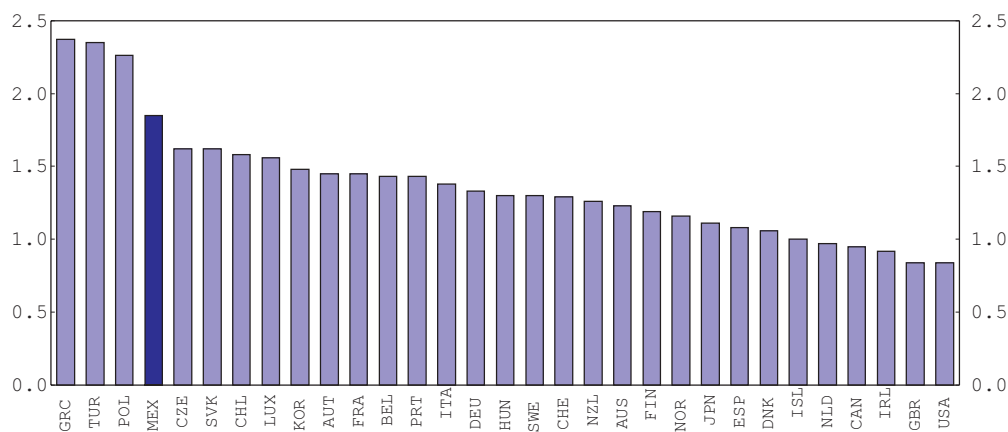
the formal sector more attractive. Mexico should move towards unifying social protection across the formal and informal sectors, to improve spending efficiency and avoid distorting the incentives to switch to the formal sector. These issues will be analysed in greater detail in the OECD's next Economic Survey of Mexico.

Long-term growth

Mexico's economic performance over the past 20 years has not fulfilled its potential, in contrast to the dynamism of other emerging economies. If Mexico fails to achieve a substantial increase in its long-term growth rate, it will take it several generations to attain a standard of living comparable to other OECD countries. Reforms to enhance the quality of primary and secondary education, strengthen competition and improve the regulatory framework will be essential in this respect, since they will increase the potential for productivity growth and improve the investment environment. Fortunately, progress has been made in education in the form of increased spending on school infrastructure; the introduction of a centralised entry exam for teacher hiring, for the first time in 2008; and a plan to link teachers' career advancement more closely to performance. The government has also proposed a labour reform, which – if passed – could have a very positive impact on formal employment.

As regards competition, Mexico has made significant progress, especially in banking reform (among other things, by easing entry regulations and reducing the cost to customers of changing from one financial services provider to another), and in trade reform (by instituting across-the-board import tariff reductions). The Chamber of Deputies' recent adoption of a series of reforms to the Competition Law, by a wide majority, is an important first step towards passing the law, which is in line with international best practice. Its implementation would represent a major step forward for competition and consumer welfare in Mexico. The reform would create heavier sanctions for cartels, make collusion a criminal offence, provide for non-adversarial settlements where those implicated co-operate with the authorities, and give the Federal Competition Commission more power. The OECD Competition Assessment Toolkit has been a key source of support in designing and furthering these changes. The reform now needs to be passed urgently by the Senate, ideally without substantive amendment.

Regulation in the goods market (2008): the greater the value the more regulation



Source: OECD, Product Market Regulation Database.

In the regulatory area, the government, with OECD support, has instituted a one-stop shop for completing the formalities of starting a business, which reduces the time needed to just one day. Nonetheless, there is still room to increase the effectiveness and impact of market-access regulations in network industries, to enhance competition, and to reduce or remove barriers to private investment in sectors such as telecommunications and electricity.



Key OECD Recommendations

- Maintain a monetary policy stimulus in the near term, in view of the weakness of domestic demand, large unused productive capacity and a moderate inflation outlook. Pursue a prudent fiscal policy, in view of the foreseeable decline in oil production, which currently provides the bulk of fiscal revenues.
- Broaden the tax base by removing inefficient tax expenditures and by strengthening incentives to operate in the formal economy; review expenditure efficiency and reduce energy subsidies.
- Continue efforts to reallocate education resources towards non-wage expenditure, and review incentives for teachers to improve students' learning outcomes.
- Continue strengthening competition legislation, through Senate passage of the current reform initiative, and facilitate implementation of the proposed changes.
- Increase the effectiveness and implementation of regulations that encourage and improve competition and access to markets; remove obstacles to private investment in the electricity and landline telephony sectors, and strengthen initiatives that simplify business regulation.



Labour Market

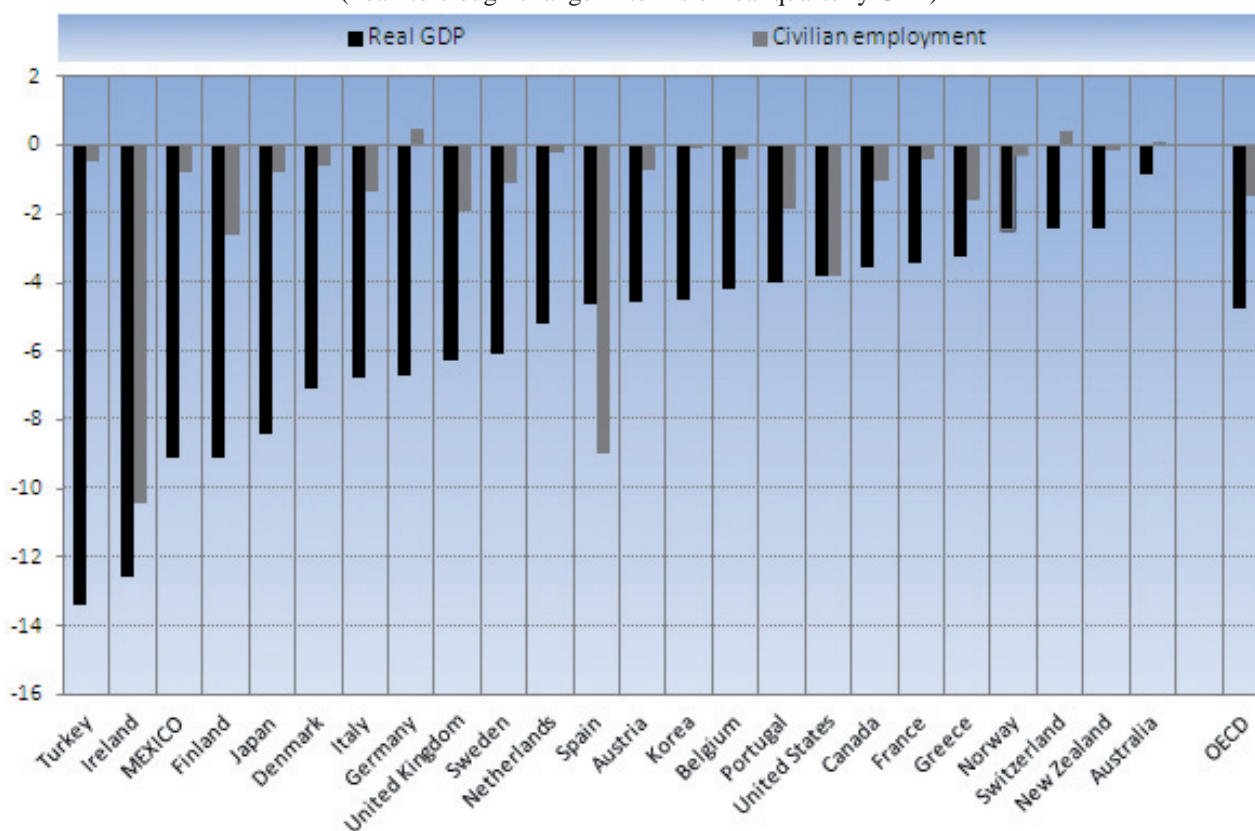
The contraction in Mexico's GDP, caused mainly by a slump in exports, and compounded by the credit crunch and a drop in remittances, was quickly felt in the labour market. Nonetheless, the employment impact has been moderate, with less than 1% of jobs being lost between the peak of the business cycle (2008Q1) and the trough (2009Q1). Nevertheless, unemployment did hit a historic high of 5.9% in August 2009, when nearly 3 million people were out of work and the data showed a considerable increase in informal work and under-employment. As of July 2010, the employment rate was still one percentage point below its pre-crisis level, while unemployment, at 5.4%, remained almost two percentage points above.

Employment and real incomes

As the current crisis originated abroad, its impact on Mexico has been very different from the demand shock that occurred in the mid-1990s. The 1994-95 event was a balance of payments crisis triggered by domestic imbalances, which resulted in a substantial devaluation of the peso. That led in turn to a recovery in net exports and sharply higher inflation which seriously eroded real wages. In contrast, the direct effects of the current crisis have mainly been felt in exports and manufacturing. Adjustment in the labour market mainly took the form of lost jobs, although median hours worked and real incomes also fell.

The deep recession in Mexico was accompanied by a relatively small decline in employment

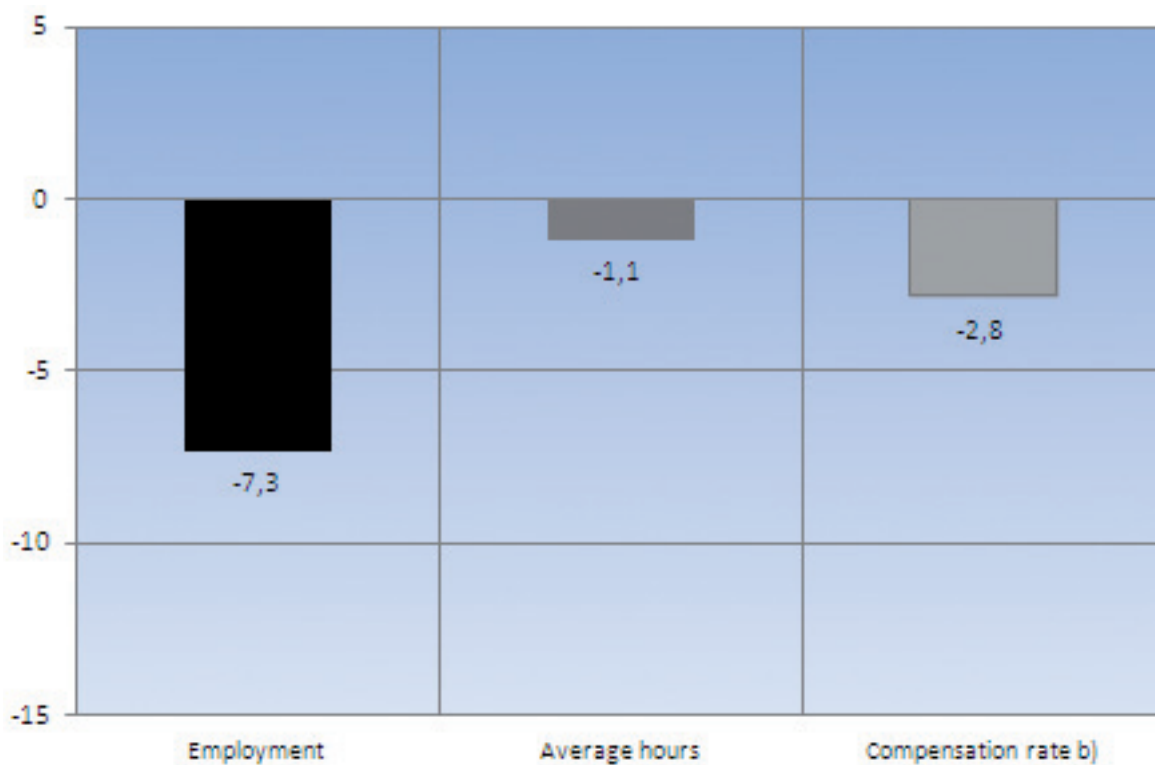
(Peak-to-trough change in terms of real quarterly GDP)



Note: 2007 Q4 to 2008 Q1 for the Slovak Republic; 2007 Q4 to 2009 Q1 for New Zealand and Sweden; 2007 Q4 to 2009 Q2 for Canada, Denmark, Norway and the United States; 2007 Q4 to 2009 Q4 for Ireland; 2008 Q1 to 2009 Q1 for France, Germany, Japan, Mexico, OECD area, Portugal and Turkey; 2008 Q1 to 2009 Q2 for Italy and the Netherlands; 2008 Q1 to 2009 Q3 for Hungary and the United Kingdom; 2008 Q2 to 2008 Q4 for Korea; 2008 Q2 to 2009 Q1 for Belgium; 2008 Q2 to 2009 Q2 for Austria, Chile, Finland and Switzerland; 2008 Q3 to 2008 Q4 for Australia and Poland; 2008 Q3 to 2009 Q1 for Israel; 2008 Q3 to 2009 Q2 for the Czech Republic and Slovenia; 2008 Q3 to 2010 Q2 for Greece and Iceland.



Margins of labour market adjustment in the Mexican manufacturing sector during the crisis



a) Compensation rate = total real compensation per employee (deflated by the private consumption deflator)

Source: OECD estimates based on INEGI Encuesta Industrial Mensual (EIM), which covers the manufacturing sector only.

Formal employment was strongly affected but has now recovered

Workers in the formal sector were the first to be affected by the current crisis. The number of workers registered with the Social Security Institute (IMSS) fell by 2.6% between March 2008 and March 2009. A large proportion of the formal workers laid-off were temporarily absorbed by the informal sector, which already accounted for a significant share of wage-earners. Formal employment started to rise again after March 2009; and, in July 2010, the number of workers registered at IMSS was back to its pre-crisis level.

As in other OECD countries, the most vulnerable (women, young people and unskilled/semi-skilled workers) are likely to have been hardest hit by the crisis. These groups are particularly sensitive to shocks in the manufacturing sector, because that part of the labour market is highly segmented.

Measures to mitigate the effects of the crisis

Automatic stabilisers are relatively undeveloped in Mexico in comparison with most OECD countries. At 7.5% of GDP (2005), public social expenditure is low—the second lowest in the OECD area ahead of Korea. Funding for workers at times of crisis is limited, given the absence of unemployment insurance and the minimal resources available for active labour-market policies (ALMPs), which represented less than 0.1% of GDP in 2007. However, the fact that the country's fiscal position was better at the onset of this crisis than at the start of the 1994-95 episode has allowed the government to implement counter-cyclical fiscal policy. A number of programmes were introduced in 2008 and 2009, mainly targeting infrastructure. In all, the fiscal stimulus generated by the government's crisis-related discretionary measures represented 1.5% of GDP in 2009.



The Mexican government also took a number of important measures on the employment side. The temporary Employment Programme, which provided jobs to 700,000 individuals for 10-12 weeks each, expanded by 70% in 2009, and the number of participants doubled. Thirty thousand jobs were created in urban areas. A temporary part-time work scheme was also introduced in 2009, providing subsidies to businesses that had been forced to cut production, mainly in the automotive sector. Supplementing this was a reduction in social security contributions for firms hiring new workers or those at risk of losing their jobs. Finally, to support unemployed workers, eligibility criteria for drawing on individual retirement accounts were eased, and the government's contribution to these accounts was increased. Coverage periods for health and maternity leave benefits were extended, and special mortgage relief was provided. Finally, the National Employment Service was strengthened by increasing funding for job-search assistance and training programmes.

Broad labour market reform

The government recently submitted an ambitious proposal for comprehensive labour-market reform to Congress, in which the proposed changes would affect approximately 40% of the 1000 articles of the Federal Law of 1970. Its key objectives include:

- More flexible wages, and closer linkage between wages and productivity. This is to be achieved mainly by giving a greater role to individual wage-setting mechanisms and by allowing more flexibility to alter wages, with productivity playing a more important role.
- Lower lay-off costs. This is to be achieved by increasing incentives for rulings on cases of unfair dismissal to be made quickly, and by eliminating the right to reinstatement for workers with less than three years on the job.
- Greater job opportunities for under-represented groups (young people, women, disabled individuals). A number of measures have been designed to facilitate access and improve working conditions, strengthen anti-discrimination provisions, protect women in the context of maternity, and eliminate priority lists based on seniority.
- Greater transparency and representativeness in unions.
- Modernisation and simplification of the judicial system as it affects labour relations.

The OECD has long recommended that Mexico undertake a comprehensive reform of its labour markets so as to promote the creation of more and better jobs for all. The proposed labour reform is an important step in this direction.

However it will be vital to improve enforcement capacity for the new laws to be effective. The reforms proposed to increase the penalties for non-compliance with labour laws and to streamline certain labour court and inspection procedures are welcome. But Mexico should also increase resources for labour inspection, which lag international best-practice for a country of Mexico's development level and are disproportionately focused on larger businesses.

Key OECD recommendations

- Revamp incentives for low-income workers to move into the formal sector. In particular, improve social security coverage and access to services in areas such as housing and child care.
- Strengthen measures for tax and social security compliance, as part of a comprehensive strategy to encourage informal workers to register their activity. In particular, the tax system should be simplified. The government could also consider making social security contributions compulsory for self-employed workers, especially those with incomes above a certain level.



- Improve the balance between labour-market flexibility and worker protection, by extending legal grounds for dismissal and replacing the severance payment regime with a system of individual savings accounts.
- Make more room for short-term and part-time work contracts, which can be useful in encouraging women's participation in the labour market.
- Introduce new types of training arrangements similar to those known as apprenticeship contracts in various countries, and make more use of probation periods to facilitate the generation of long-term job contracts. Both of these mechanisms should be properly regulated to prevent abuse.
- Promote training by improving information and guidance on existing opportunities. The creation of short-term training modules would make it easier for workers to acquire training without leaving their jobs.

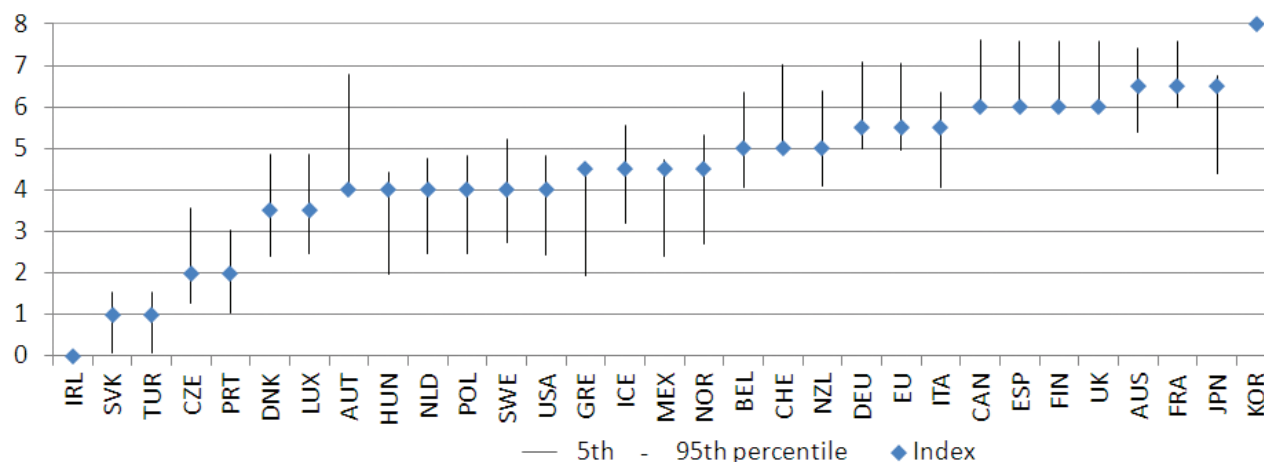


Regulatory Policy

Business regulation in Mexico remains complex, hampering entrepreneurship and structural change, and encouraging informality. To help bring down the cost of opening a business, the Ministry of the Economy launched a one-stop-shop (tuempresa.gob.mx). The OECD estimates that this facility could bring administrative costs down by about 65%.

Regulatory complexity contributes to uncertainty and encourages disrespect for the law, as well as corruption. A Presidential initiative to update the entire stock of federal regulations 2010, Acuerdo para Consolidar la Regulación Base Cero, aims to eliminate those that are unnecessary and inhibit trade and the take-up of innovation. To prevent low-quality regulations being re-introduced, Mexico needs a robust and effective system for regulatory impact analysis.

Dynamic process of evaluation and update of regulations (2008)



Note: This graph summarises information on the processes of updating and evaluating existing regulations in OECD jurisdictions. It does not gauge whether the efforts made by these countries have been effective. A high indicator refers to regular quality control of regulations to assure suitability and avoid duplication or redundancy; and a low indicator, the lack of checks using regular reviews, standardized evaluation, and public consultation.

Source: OECD Regulatory Management Systems' Indicators Survey 2008. www.oecd.org/regreform/indicators

In a federal system, a regulatory programme must reduce the gap between well-performing and other states, and encourage the most competitive ones to set new goals. Regulatory barriers to business call for measures to reduce bureaucracy, improve access to infrastructure, and speed up the process of issuing land use and building permits.

Key OECD Recommendations

- Extend the one-stop-shop across the life cycle of business, to cover regulatory formalities from inception, to growth, and then extinction; make *tuempresa* the most frequently used gateway for business.
- The federal government can encourage early adopters amongst the states to go further, and other states to start, adopting best practice and reforming regulatory systems.
- Focus regulatory impact analysis on the regulations likely to generate the highest costs or greatest benefits; deepen and broaden the review of regulations across ministries, using task forces that draw on stakeholder expertise.



Budgeting and public-sector efficiency

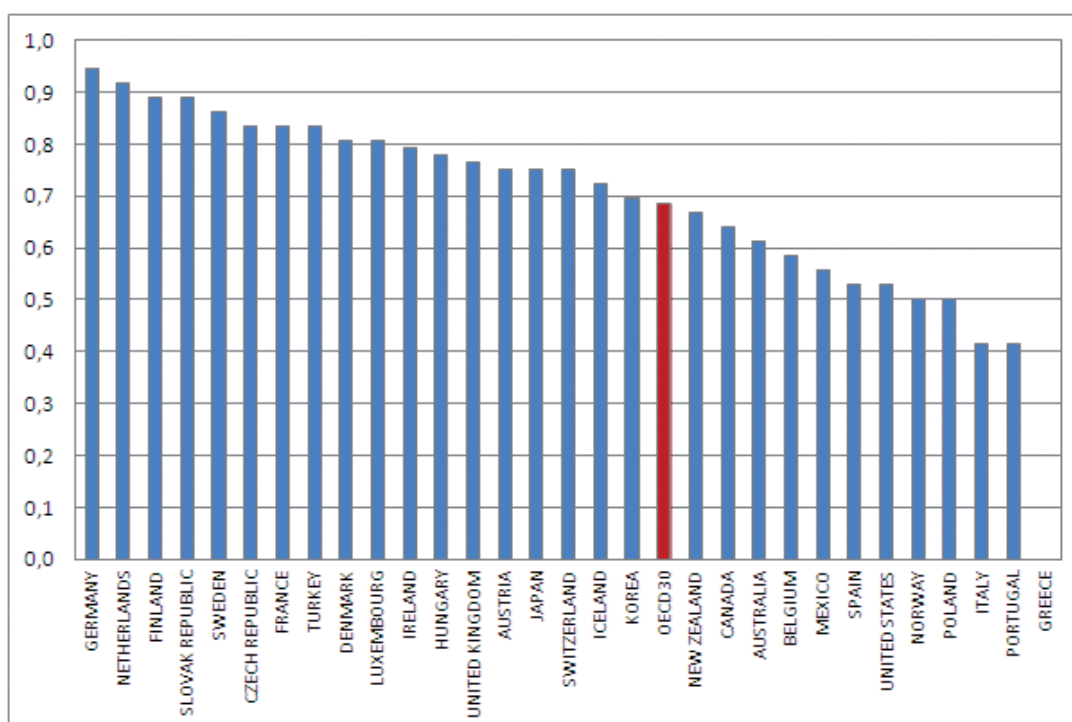
Since 2006, Mexico has introduced a number of laws to enhance fiscal responsibility and transparency. Legislation, however, is but a first step; strong ongoing support is needed at all political levels – federal, state and local – to ensure that the laws are implemented and used. The financial crisis should be seen as an opportunity to hasten progress, moving forward with important reform initiatives that promote real change.

Improving the budget process

To achieve sustainable public finances in the long term, Mexico needs to make its budget less dependent on oil revenues and improve its overall economic growth rate. The efficiency and effectiveness of public expenditure and the accountability of spending at the sub-national level also need to be strengthened. Among other measures, the country needs to develop a longer-term budget focus, with a three-year time horizon that aligns spending and funding with the government’s plans and goals for different sectors. This would make it easier to prepare for eventualities such as declining oil revenues and changing demographics.

It will also be necessary to incorporate performance data into the budgeting process, to shift the focus away from inputs and towards outcomes, and thus help the public sector to focus on results. New incentives and regulatory structures will be needed to rationalise budget execution and management and make these processes more flexible. Congress should be involved in this process and be encouraged to make more use of outcome data and evaluations presented by the executive branch, both to monitor the performance of important ministries and agencies, and for the purposes of budgetary debate.

Use of the medium-term perspective in the central government budgeting process



Index range: 0 (no medium-term budget solidity) to 1 (high medium-term budget solidity). Cronbach’s alpha: 0.738 (computed with SPSS). A Cronbach’s alpha in the neighbourhood of 0.6 or 0.7 indicates a high degree of correlation among a set of variables.

Source: *Government at a Glance*, OECD, 2009

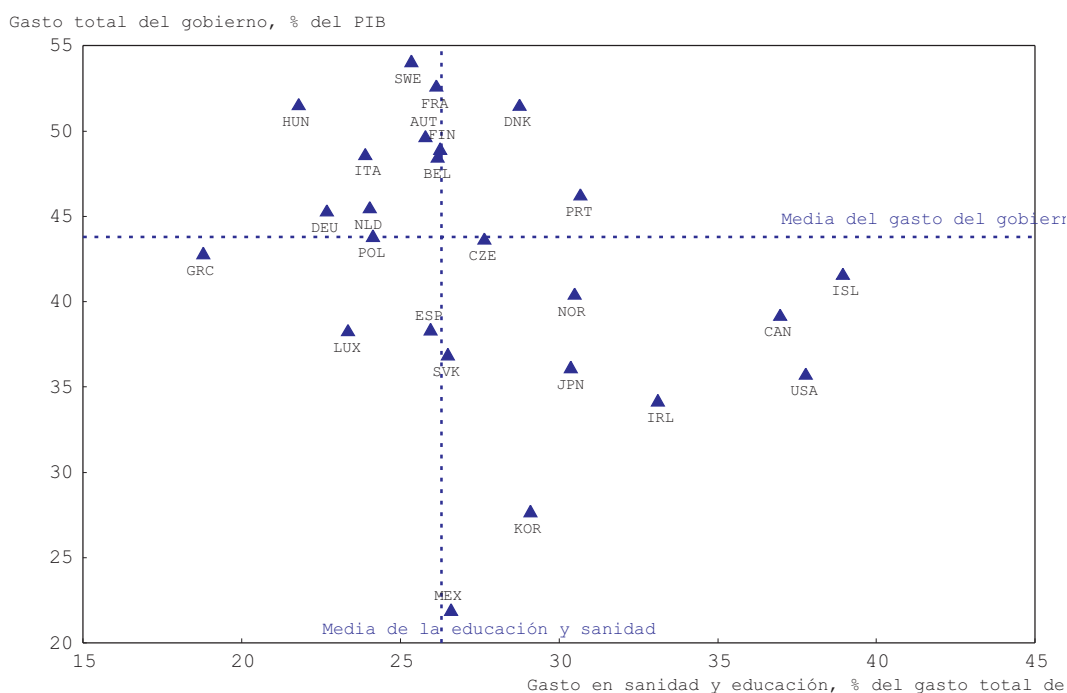


Public-sector efficiency

The public sector must significantly improve strengthen its human resource management, both to improve policy making and to ensure more efficient, effective and competitive provision of services. Public employment should be seen as a strategic element in any attempt to reform public administration, with the emphasis on improving productivity. With the Law to Professionalize the Civil Service, the federal government has embarked on a process of professionalisation, which should help civil servants to be more effective.

Although Mexico's public spending is relatively low in relation to GDP (21.9%, or approximately half of the OECD average), quantity is not the only issue here; quality is equally important. Health and education are two strategic areas where the efficiency of public spending needs be improved. Inequalities in health and education across social groups and between different federal states reflect incomplete coverage, fragmentation and poor service provided to much of the population. The potential to improve the allocation of existing resources in both of these areas is enormous.

Health and education expenditure as a percentage of all government spending ¹



1. Refers to general government

Source: OECD, National Accounts and Analytical Database, Anexo Estadístico del Segundo Informe del Gobierno

Public-sector efficiency also requires building sub-national capacity and fostering co-ordination across different levels of government. E-government can be particularly useful in this area.

The case of the water sector

In the crucial water sector, preliminary findings from Mexico's participation in the OECD Water Governance Survey (2009-2010) highlighted key obstacles to the efficient co-ordination of water policy between different ministries and public agencies, and across different levels of government. The obstacles include lack of clear leadership in water policy-making, insufficient staff and time, difficulties in implementing central government



decisions at the local and regional levels, the absence of strategic planning and effective sequencing of decisions, and sub-national government revenues that are unstable or insufficient for implementation of effective water policy. Although the sector has co-ordination mechanisms, the diversity of actors poses a serious challenge for water management. The organisations involved include a ministry (SEMARNAT), a government agency (CONAGUA), an inter-ministerial body (the CONAGUA technical committee), inter-agency programmes, river basin organisations, regulations, contractual arrangements, databases and financial transfers.

Key OECD Recommendations

- Develop multi-year budgeting, with a focus on expenditure performance and effectiveness, and on outcomes in the public sector.
- Involve Congress in drafting the budget, encouraging its members to participate in budget debate.
- Eliminate unnecessary regulations and simplify administrative procedures; and involve the business community in evaluating the regulatory structure.
- Engage sub-national governments in the regulatory reform programme, taking account of federal approaches to improving national competitiveness.
- Improve public-sector effectiveness by professionalizing the civil service, taking steps to enhance expenditure quality, and expanding transparency and open government initiatives.
- Build capacities at the sub-national level, and foster co-ordination between levels of government to achieve an integrated approach on key policy areas such as water.



Tax System

Mexico's tax/GDP ratio is well below that of other OECD countries, although its nominal tax rates are not particularly low in that context. This suggests that its tax base is considerably smaller than those of other OECD countries, either because it is more narrowly defined in legal terms or because of weaknesses in tax administration and collection processes. Although Mexico obtains a large proportion of its total revenue from oil-related taxes, these cannot be counted on as a stable source of income in the long term.

Broadening the tax base and simplifying taxation

Despite a number of reforms in recent years, tax exemptions, deductions and preferential regimes remain in place, damaging and distorting incentives, and complicating tax administration. The value-added tax base remains very narrow, and only a small part of the potential base is actually being taxed. There is a common but false perception in Mexico that a zero VAT rate and VAT exemptions are ways of reducing inequality. In fact, the most affluent households gain most from these provisions, since they buy more goods in general than poorer households.

Property tax provides the bulk of municipal revenues (59%). However, enforcement is uneven, and collections are much more limited than in most OECD countries. Mexico's antiquated property records have been a major constraint, while weak local administrative capacity and obsolete property valuations add to the problems. Local tax administration and administrative collection of taxes need bolstering.

It is also important to eliminate subsidies on fossil-fuel consumption, in line with measures that have already been announced. A special tax based on the carbon content of energy consumed should replace those subsidies, to reduce emissions and mitigate the effects of climate change.

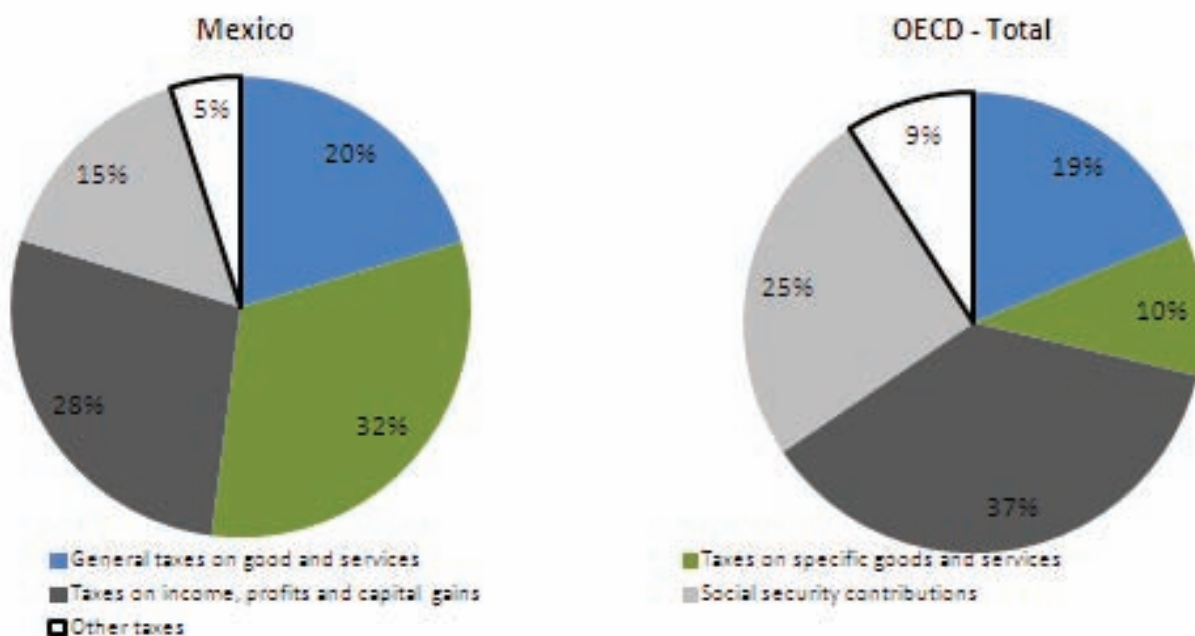
Combating the use of tax havens

The fact that Mexico is in a region that abounds in tax havens gives the country's taxpayers opportunities to evade taxes. Recent OECD and G20 initiatives have attempted to counter such evasion by fighting the lack of transparency in such low-tax jurisdictions. Mexico has played a key role in these endeavours by hosting the 2009 Global Forum on Transparency and Exchange of Information for Tax Purposes; and it has successfully negotiated several tax treaties and other agreements (with Panama, for example) that provide for full exchange of information.

To strengthen the impact of these voluntary compliance efforts, Mexico should now: (1) launch a voluntary disclosure campaign to encourage taxpayers to come forward and declare previously undeclared assets and income, along the lines of those already undertaken by the UK, US and other OECD countries; (2) increase funding for key personnel in the Tax Administration (SAT) to pursue cases of international tax evasion, and develop training programmes for auditors on how to make best use of these new tools; and (3) strengthen its participation in multilateral efforts to tackle international tax avoidance and evasion (Mexico's ratification of the OECD/Council of Europe multilateral Convention on Mutual Administrative Assistance will be a great help in this respect).



Mexico's taxes in comparison with other OECD Countries



Creating strategies for tax reform

Implementing reform is difficult in Mexico, as in the rest of the world. To achieve higher levels of voluntary tax compliance, the government should, among other things, take steps to convince the electorate that its taxes are spent efficiently. A major communications effort will be required to promote a revenue-enhancing tax reform. The government should stress that no new spending can be considered on the basis of the existing weak revenue base. The system's numerous tax exemptions, deductions and preferential regimes weaken the government's ability to generate revenue and improve public services.

Key OECD recommendations

- Mexico should consider fundamentally reforming its tax system, given the need to increase spending on poverty reduction, invest more in infrastructure, cut budget deficits and reduce its dependency on oil-related tax revenues.
- The tax reform should increase revenue by broadening the tax base and further strengthening tax administration.
- Revenue should also be increased by bringing more taxpayers into the system and limiting Mexican taxpayers' use of tax havens. A comprehensive tax reform is needed, which would address the issue of fiscal federalism and also provide effective implementation strategies.



Competition

The Mexican economy has been burdened by anti-competitive conduct and regulation for many years. According to a joint Mexico-OECD project, 30% of household spending in Mexico takes place in uncompetitive markets; and the lack of competition results in consumers spending about 40% more in those markets than they otherwise would. The situation is even worse for the poorest population decile, which spends roughly 42% of its income in highly concentrated markets.

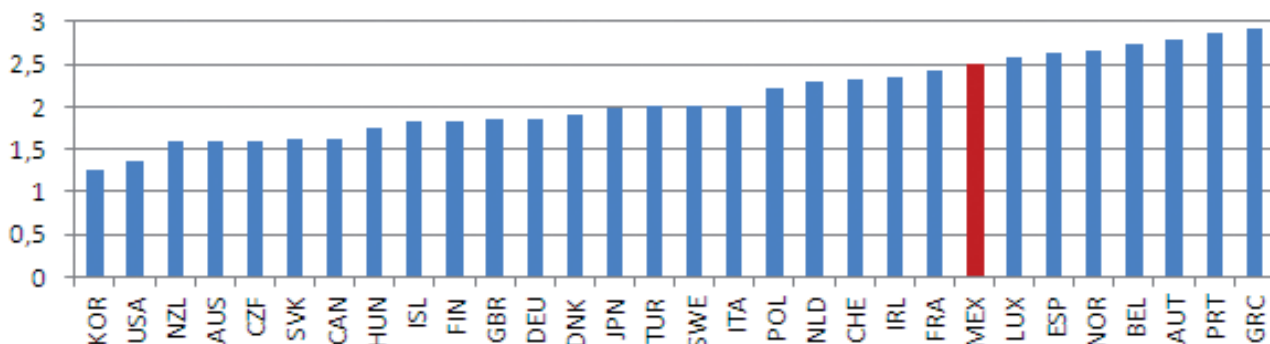
In a nutshell, monopolies and duopolies lead to excessively high prices for goods and services, limiting households' consumption and capacity to save; and it is the poorest households that are affected most. In the medium term, monopolies have a negative impact on an economy's overall efficiency, and they constitute a drag on economic growth. A lack of robust competition in domestic markets undermines the efficiency and competitiveness of Mexico's economy, contributes to widening income disparities and inhibits innovation.

Strengthening competition law

Although Mexico's Federal Competition Commission has played a positive role, the legal framework on competition is one of the weakest in the OECD, owing to its inadequate enforcement provisions.

Legal framework to prevent monopolistic practices needs strengthening

(Scale of 0 to 6: from most to least favourable for competition)



Source: Høj, J. (2007), "Competition Law and Policy Indicators for the OECD countries", OECD Economics Department Working Papers, No. 568, OECD Publishing.

This picture should soon change. The Chamber of Deputies recently passed an important initiative amending the Competition Law, and the proposal is now being debated in the Senate. This is a major step forward. The reforms effectively address weaknesses in the law, and have the potential to create the conditions for an effective competitive framework. Among other things, they raise the cap on fines for monopolistic practices to 10% of a company's billings in Mexico, make criminal sanctions applicable for participation in cartels that impair competition, guarantee the right of interested parties to be heard by the full panel of the Competition Commission, permit settlement agreements and give the competition authority investigative powers that are on par with the best international practices. If these amendments are adopted and duly implemented, the new Competition Law could make a decisive contribution to increasing Mexico's productivity and competitiveness.



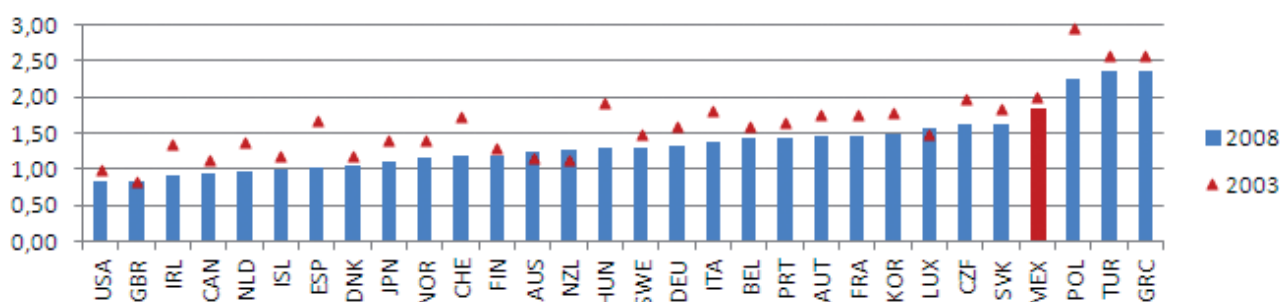
Scaling back regulation in the product market

Product-market regulation in Mexico, which is among the strictest in the OECD, hinders competition; and the latest OECD aggregate indicator shows that little progress has been made in recent years. This impedes productivity and curtails growth, as it prevents more productive firms from entering the market and expanding, thus holding back investment and innovation.

In 2008, Mexico and the OECD launched a project to assess the competitive impact of regulation and promote competition. The project has already contributed to beneficial changes in trade policy and banking regulation; and it has generated recommendations that would yield more than USD 10 billion in benefits per year if adopted. The project runs through 2012.

Regulation in the product market remains strict

Scale of 0-6: from least to most restrictive



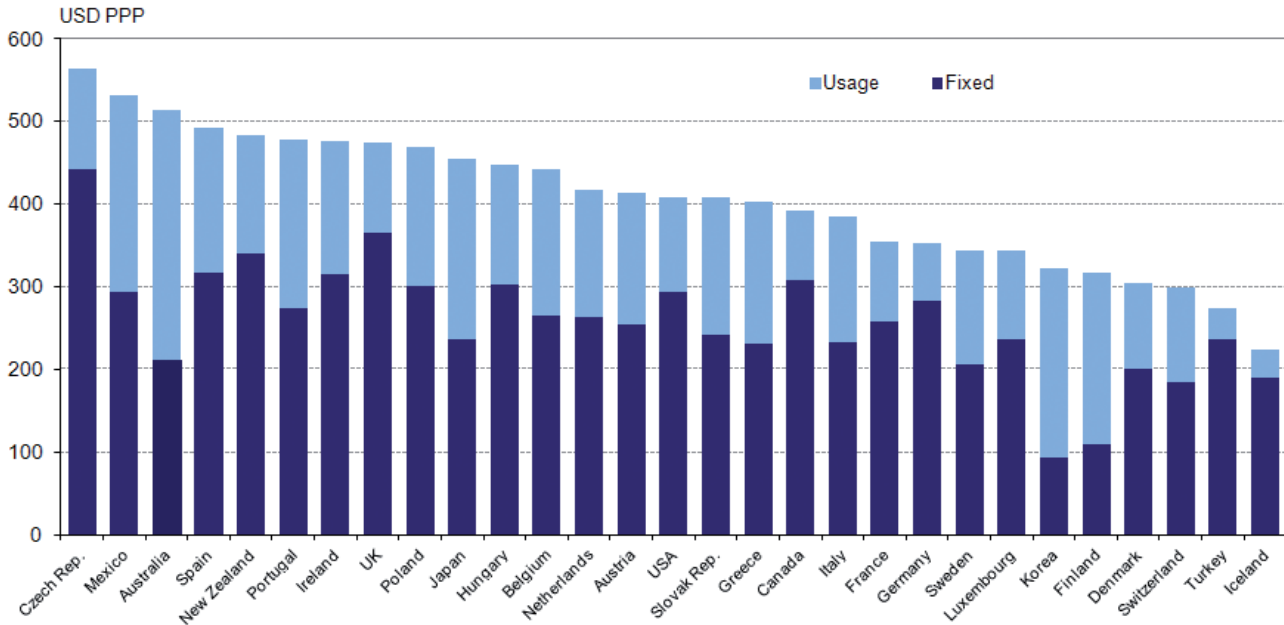
Source: OECD (2010), Product Market Regulation database, <http://www.oecd.org/eco/pmr>.

Regulation in the product market needs to be scaled back, and competition needs to be fostered in many areas. The legal framework should expand business capacity and incentives, thereby facilitating competition. Mexico could continue with and extend its own efforts to review and eliminate anti-competitive restrictions on business activity. The government should continue its programme of assessing competition and focus on implementing the OECD Competition Assessment Toolkit, which includes a checklist with a series of simple questions to identify laws and regulations that may restrict competition unnecessarily.

Opening network industries to competition

Competition in network industries remains weak. Although many state-owned enterprises have been privatised, the government remains heavily involved in economic activity. The energy and water sectors have high levels of public ownership, and their firms are vertically integrated. The prices of services in the telecommunications sector are high in comparison with other OECD countries, even though the sector is privatised.

OECD Basket of Residential Telephone Charges (low usage)



Note: The OECD basket of residential telephone charges includes fixed access and 600 calls (broken down according to distance, destination [fixed, mobile, international], and time of day) over a one-year period.

Source: OECD

Renewed efforts are needed to promote competition in network industries. The existence of strong, independent and effective regulators is crucial. The amendments to the Competition Law, recently passed by the Chamber of Deputies and about to be passed the Senate, could make a decisive contribution to improving competition in these strategic sectors.

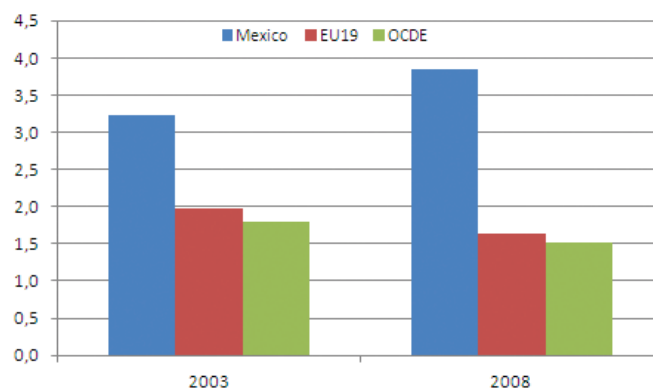
SME support

The bureaucracy involved in starting a business in Mexico remains relatively onerous compared to the OECD average. The administrative burden on start-ups increased between 2003 and 2008, whereas it decreased across the OECD. This puts pressure on the economy, since the majority of economic activity and most jobs are generated by small and medium-sized businesses. Bureaucracy also affects innovation and knowledge transfer indirectly, since start-ups are the main source of innovation and growth.

AVANCE is the national programme aimed at identifying and exploiting business opportunities based on scientific and/or technological developments. This initiative supports the stages of the enterprise innovation process and helps, mainly SMEs, to commercialize their innovations. Despite its apparently modest results in terms of the resources awarded and the number of firms that have received benefits, there is some evidence that this programme has generated a number of indirect results of importance for the future of the innovation system in Mexico. Firstly, it has increased investor interest in technologically innovative projects. Secondly, it has fostered the creation of technical capabilities to identify and evaluate innovative projects, which were nonexistent in Mexico until a few years ago. Thirdly, it has promoted the creation of business angel and venture capital funds, which had been virtually absent in the country; and lastly it has favoured a culture of innovation management in the National Council for Science and Technology (CONACYT) and other agencies.



The administrative burden on business start-ups



Index scale of 0-6, from least to most restrictive.

Source: OECD, Product Market Regulation Database. OECD 2010, SMEs Innovation and Entrepreneurship.

The rule of law

According to several recent studies, problems with the rule of law remain Mexico's greatest outstanding obstacle to growth. Compared to the 10 fastest growing countries, the 1997 Sala-i-Martin model shows that the rule of law in Mexico weakened between 1996 and 2007 in both absolute and relative terms. The enforceability of contracts, in particular, is weak. This situation is reflected, for example, in much higher debt-recovery costs than those prevailing in the OECD and many other emerging markets, including Argentina, Brazil, Chile and China.

Lack of security in Mexico has also become a very significant competitive disadvantage. Recent government estimates show that security problems are reducing growth by about 1.2 percentage point per year. Mexico needs to continue its efforts to strengthen the rule of law, to enable the judicial system to provide a reliable framework for business activity.

Key OECD Recommendations

- Promote Senate passage of the recent initiative to reform the Competition Law, and strengthen enforcement provisions.
- Continue the review and amendment of laws and regulations that unnecessarily restrict competition.
- Add competition assessment to the regulatory impact analysis overseen by the Federal Commission for Regulatory Improvement (COFEMER).
- Foster competition in network industries. Encourage the existence of strong, independent and effective regulators.
- Ease the administrative burden on business start-ups.
- Ensure coordination between enterprise support programmes and the regulatory frameworks governing businesses.
- Make it possible for already established businesses to grow and develop by streamlining administrative procedures.



Inequality

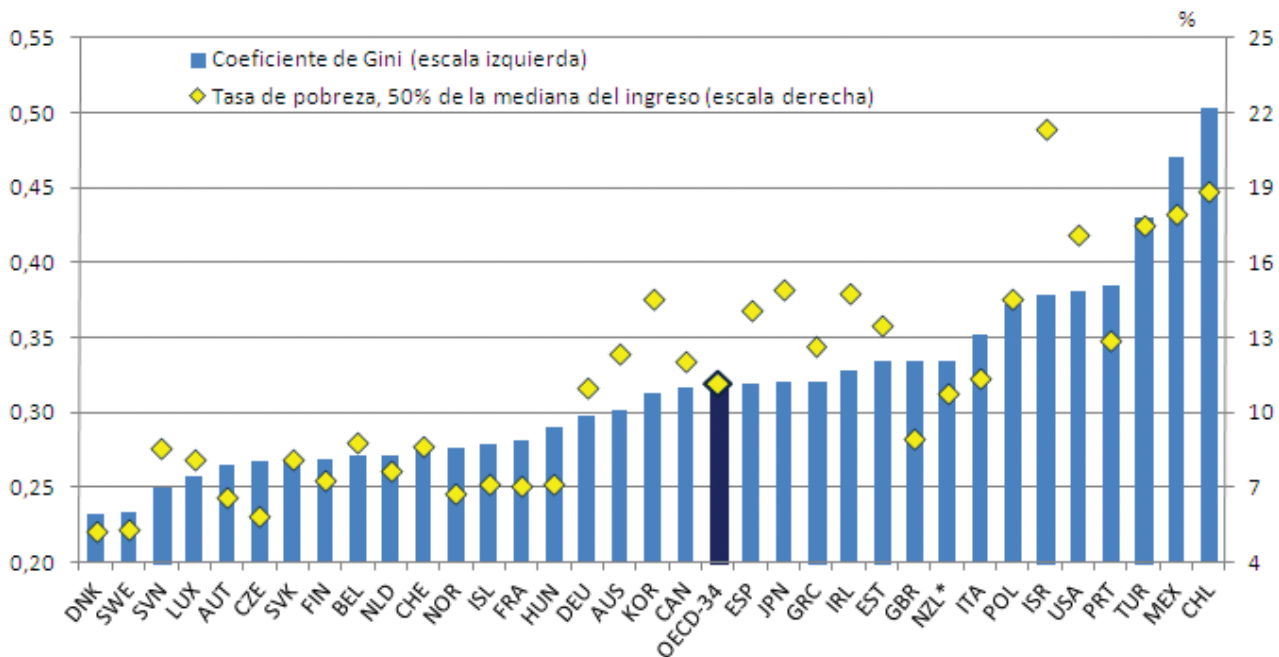
Despite a reduction between 1996 and 2006, income inequality in Mexico is still the second highest in the OECD, behind Chile, one and a half times the OECD average, and twice as high as in low-inequality countries such as Denmark or Sweden. While income in the wealthiest decile in OECD countries averages roughly nine times the income level of the poorest decile, the equivalent gap in Mexico is 27 times.

High levels of income inequality

According to the OECD study “Growing Unequal? Income Distribution and Poverty in OECD Countries” (2008), the bottom 10% of the distribution in Mexico receives around 1.3% of total disposable income, while the wealthiest 10% receives close to 36%.

Levels of income inequality and poverty in OECD countries

in the middle of the 2000-2010 decade



Source: OECD income distribution questionnaire (2010).

Despite progress in recent decades, poverty is on the rise again. Between 2006 and 2008, the proportion of people earning below 50% of median income increased from 19% to 21%. The percentage of Mexico’s population living in extreme poverty (on less than USD 1.25/day) doubled from 2% to 4%, while the proportion living on less than USD 2/day rose from 4.8% to 8.2%. Official figures for absolute poverty, which take account of access to food, health, education, housing and other factors, rose considerably as well. The high level of absolute poverty is also reflected in other indicators of living conditions: infant mortality is three times the OECD average, and the illiteracy rate is above the OECD median.



Vulnerable sectors and social protection

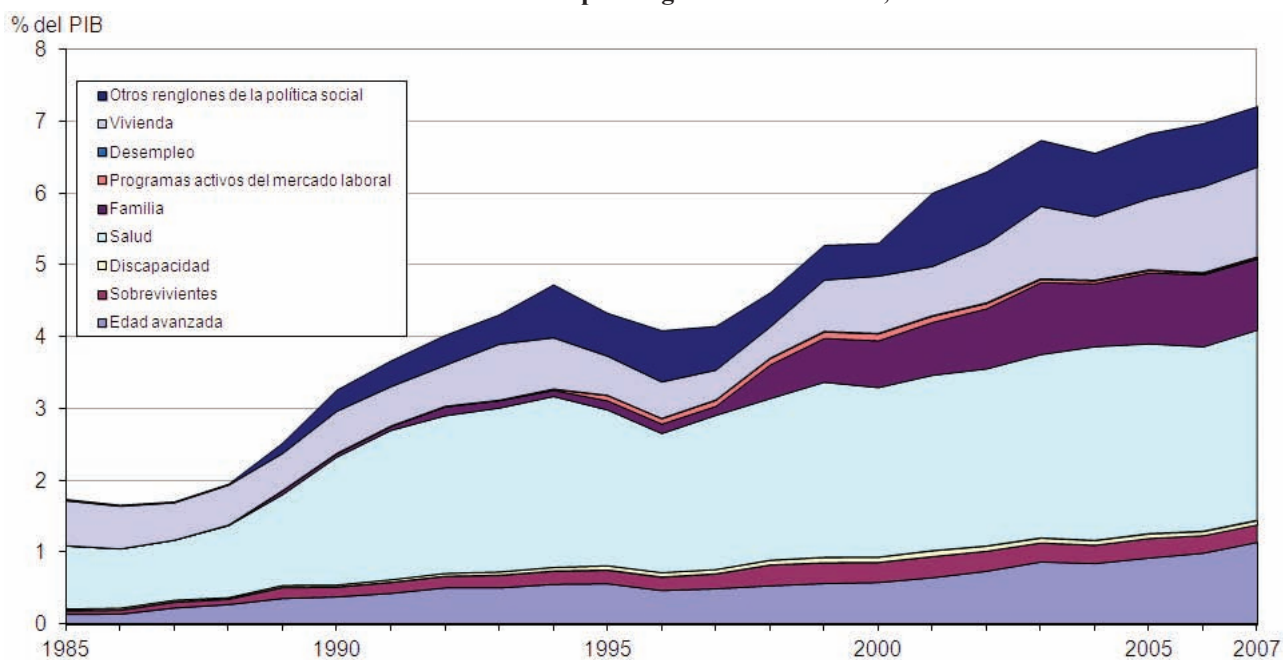
Mexico stands apart from other OECD countries in terms of the overall distribution of household disposable income. Most middle-class incomes are much closer to the incomes earned by workers at the low end of the scale than to those at the top. While the trend over the past decade until 2006 —income gains for the bottom quintile and losses in the top quintile—has reduced income inequality, the policy challenge now is to accelerate gains in lower-income groups at a time when per capita income is recovering.

As Mexico's population is comparatively young, children account for around half of all the income-poor. Thus, poverty is more likely to have lasting consequences in Mexico than in other OECD countries. The problem of poverty among the elderly is most severe among the oldest, affecting 30% of individuals of 75 and over, or one and a half times the rate for the population as a whole. Moreover, since the Mexican population is aging, there is a risk that the proportion of poor elderly will increase.

Although there has been progress, the social protection system in Mexico continues to be limited, leaving most vulnerable citizens unprotected. Public social spending grew from less than 2% of GDP in 1985 to 7.2% in 2007, but this is barely more than one third of the level in other OECD countries. The share of public expenditure that Mexico devotes to social programmes is low, not only in absolute terms but also in relation to per capita GDP.

Social transfers do little to reduce poverty in Mexico. Public assistance accounts for only some 8% of household disposable income, and most of this expenditure benefits people at the higher end of the distribution, with about 10% going to the poorest 20%. Making the social security system more progressive and broadening its coverage is therefore a priority.

Trends in Mexico's social spending as a share of GDP, 1985-2007



Source: OECD (2010), OECD Social Expenditure database.



Poverty reduction programmes

Mexico provides an interesting example of poverty reduction. The Oportunidades programme is one of the most innovative and successful programmes targeting those living in extreme poverty or just above the threshold and benefiting 5.8 million Mexican families (2010). It has helped to raise secondary school enrolment rates, as well as the rate of successful transition from primary to secondary school (especially for girls); and, thanks to greater attendance at health centres, as promoted by the programme, child morbidity and maternal mortality have dropped (by 20% and 11%, respectively). A more recent programme, Seguro Popular, is designed to provide medical care, preventive services and financial protection for the population without health coverage in the contributory social security institutions. Individuals enrol on a voluntary basis. This programme covers around 36 million people (2010).

Despite this progress, most of Mexico's poverty reduction programmes still exclude families living in only relative poverty; and unemployment programmes remain rudimentary. The Primer Empleo programme did not have the expected impact, because it failed to provide strong enough incentives for employers to hire new workers. In times as difficult economically as they are today, Mexico needs to strengthen social safety nets to prevent moderately poor families from falling into extreme poverty. The government's crisis package includes programmes to provide temporary employment and prevent job losses (Programa de Empleo Temporal), as well as programmes extending health coverage for the unemployed by several months. However, the funding for these programmes represents just one eighth of the amount spent on keeping energy prices low. One way to provide more protection to poor families would be to shift more of the anti-crisis spending into temporary employment programmes.

Key OECD Recommendations

- Adjust the coverage of *Oportunidades* to include all segments of the poor population. Improve the quality of health-care and education supply within the programme to increase its effectiveness. Facilitate the transition from school to the labour market, by strengthening labour-market programmes for school leavers,
- Replace subsidies by cash transfers for the poorest. Review the effectiveness of programmes like DICONSA and LICONSA, and streamline the numerous existing social programmes to avoid duplication and exploit synergies.
- Analyze the mix of interventions designed to target rural poverty and promote rural development, strengthening collaboration among the numerous actors involved.
- Increase the cost-efficiency of the IMSS health-care system, to enable it to provide higher-quality services at lower cost.
- Implement measures to expand job opportunities in the formal economy. Although informal work is part of the coping strategy adopted by poor people in response to shocks, it also implies a range of social costs. Social protection is less effective for reducing poverty when low-risk groups can evade social security contributions and when the most disadvantaged groups have only limited coverage or none at all..



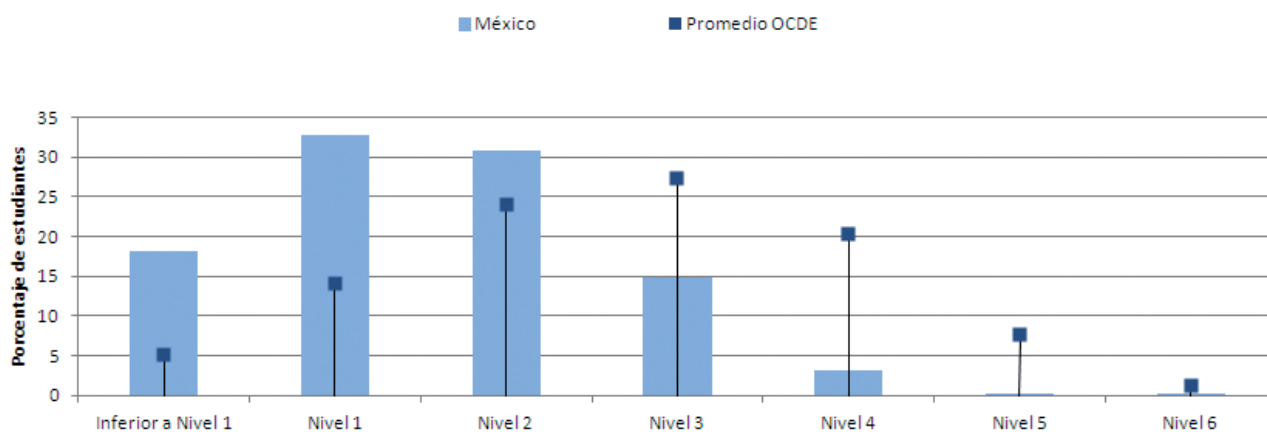
Education

The Mexican educational system has expanded rapidly, from slightly over 3 million students in 1950 to more than 30 million as of 2000. Today, nearly all children between the ages of 5 and 14 are in school; and there has also been progress in ensuring that young people finish school. The proportion of students with secondary schooling increased from 33% in 2000 to 42% in 2005, thereby reducing the performance gap between Mexico and other OECD countries. This progress has been achieved despite tight budgets and a rapidly growing school-age population, a large proportion of whom (15%) live on less than USD 2 per day.

Despite the improvement, major challenges remain. Findings from the OECD's Programme for International Student Assessment (PISA) indicate that many students lack necessary skills and knowledge. One in two 15-year-olds was below the basic skills level (PISA level 2) at that time, when the OECD average was 19.2%. Only 3% of Mexican students scored at the top levels (5 and 6), which require students to consistently identify, explain and apply scientific knowledge in a variety of complex everyday situations. The percentage of students scoring at these levels was three times higher on average in OECD countries.

Performance of Mexico in PISA 2006 (Science)

Percentage of students by proficiency level



Source: OECD, 2007, *PISA 2006 Science Competencies for Tomorrow's World, Volume 2*, OECD, Paris

Pre-primary education

Mexico should implement compulsory education from age 3. It should also underpin the quality of both early education and childcare, by improving staff qualifications and pedagogy. In addition local autonomy should be fully exercised to meet local needs, ensuring parental and community participation.

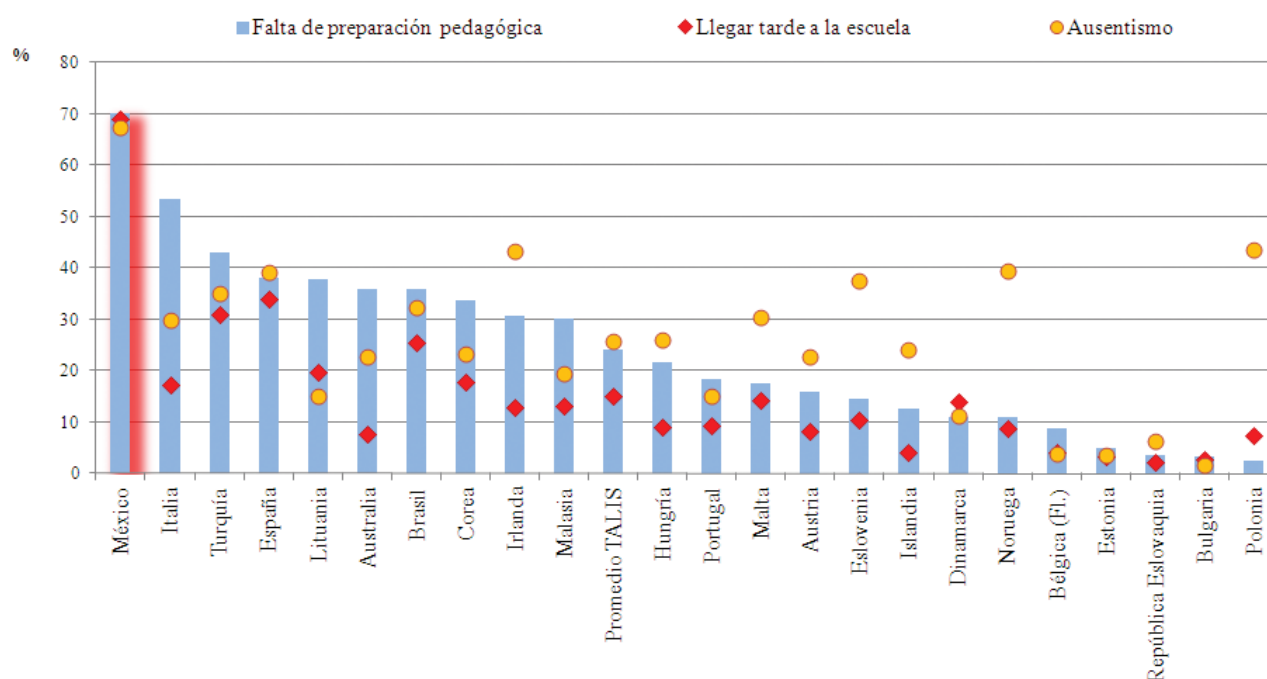
Primary and Secondary Education

To improve its education system, Mexico could learn from best practices in countries with high levels of student performance. These countries have national or state-level curricula, as well as standards and assessment mechanisms; but they delegate substantial autonomy and discretion on how best to help their students learn. Their assessment criteria focus on student achievement, equality and quality. Aware that the quality of teachers is what most influences students' learning, they invest considerable resources in the recruitment, training, development and support of teachers and administrators. Lessons from high-performing countries suggest that management and oversight in Mexican schools need to be strengthened.



Mexico needs to address problems of teacher quality, as well as absenteeism, lack of punctuality and poor pedagogical training. Improvements are also needed in teacher training programmes, in the process of assigning teachers to schools and in the country’s overall approach to the teaching profession. The constraints facing teachers individually must also be addressed. Some are obliged to teach at one school in the morning and another in the afternoon, while others have second jobs in other sectors. Nonetheless, if these changes are not supported by a well designed and properly implemented teacher appraisal mechanism, which gives guidance to on how to improve their teaching, the changes are unlikely to have a perceptible impact on student performance.

Percentage of teachers whose school principal reported that the indicated teacher characteristics hinder instruction in their school (2007-08)



Countries are ranked in descending order of the percentage of teachers citing a lack of pedagogical support as an obstacle to their teaching.

Source: OECD

Mexico’s educational system would benefit from clearly defined curricula and standards for student performance in each subject at each grade level. Appropriate requirements for teachers and school principals also need to be established and more directly linked to hiring practices and performance appraisals than they are at present. To encourage a culture of ongoing improvement and accountability, a clear plan should be established to strengthen and further develop the ENLACE assessment system, as a cornerstone of evaluation with a view to improving the quality of education.

School management and funding are also vital. Leadership should be encouraged in the training of new teachers; and state funding formulas need to be reviewed so that schools in the most disadvantaged areas receive more money per student than other schools. A range of special programmes (e.g. the PEC and Escuela Segura) should be replaced with a single programme that includes flexible subsidy provisions for all schools.



Vocational education and training (VET)

The Mexican VET system has many strengths, including initiatives to provide opportunities for learning in remote areas, measures to support students at risk of dropping out, many cases of successful labour-market entry, and excellent examples of collaboration between businesses and local vocational schools. It also faces challenges, however. For example, the professional practice model could be broadened and enhanced; and there are many ways in which teaching quality could be improved, with teacher training particularly relevant in this connection. The system could also benefit from a better organised vocational certification system, and by taking advantage of recent policy-making experience.

The will to address these challenges is clear, as numerous recent initiatives demonstrate; but there is plenty of room for improvement in five specific areas. First, Mexico's vocational education system needs a consistent mechanism of consultation between employers and schools. Second, quality standards should be introduced for internship contracts, in order to expand workplace training and improve its quality. Third, VET teachers should receive pedagogical training either before they become teachers or immediately afterwards. Fourth, Mexico could explore options for a national vocational certification framework; and, fifth, the capacity to analyse and use data on labour market needs, and to exploit links with the market, need to be developed to guide future policy design and improve decision-making.

Tertiary Education

Tertiary education is one of the keys to Mexico's modernisation for various reasons. It can provide the country with the human capital needed for sustained growth; it can promote greater social integration; and it can foster development on a broad front. The last 50 years have seen tertiary enrolment increase from 1% to 26.2% per cent in the 19-23 age bracket. Nevertheless, the level of tertiary schooling in Mexico – 19% in the 25- 34 age bracket, and just 9% among 55 – 64 year-olds – is still well below the corresponding OECD averages of 35% and 20%.

Educational spending at the tertiary level rose by 78% between 1995 and 2006. However, since the corresponding enrolment also increased very rapidly (61%), spending per student only grew by 10%. The fact that nearly all of the nation's expenditure on tertiary education is funded through the national budget raises important equity issues, since a large proportion of the spending benefits a small – and generally relatively wealthy – segment of the population. Public support is justified, however, because it facilitates access for the less affluent through student loans and scholarships; but steps need to be taken to ensure the support targets the truly needy. A reform of tertiary education funding should therefore include three essential measures: first, an assessment of the sustainability of the current cost distribution and whether this adequately reflects the relative importance of the societal benefits of tertiary education; second, improvement of the transparency with which funds are allocated to institutions, to make the allocation more consistent with overall tertiary education strategy; and third, a significant expansion of the support system for needy students.

Key OECD Recommendations

- Improve teacher training programmes, processes for assigning teachers to schools and the overall approach to teaching as a profession. These changes should be accompanied by a well designed and strictly implemented evaluation system.
- Facilitate teacher training to improve performance, using professional development methods that lead to practical improvements the classroom.
- Strengthen school management and funding, the quality of which are essential to good educational outcomes and high academic performance.



- Create a coherent vocational education and training (VET) system that emphasises teaching quality; develop a better certification system and establish a uniform mechanism for consultation with businesses to facilitate internships.
- Reform tertiary education funding, reassessing the balance between public cost and social benefit, improving the transparency of resource allocation to institutions and enhancing mechanisms that support students and promote equality.



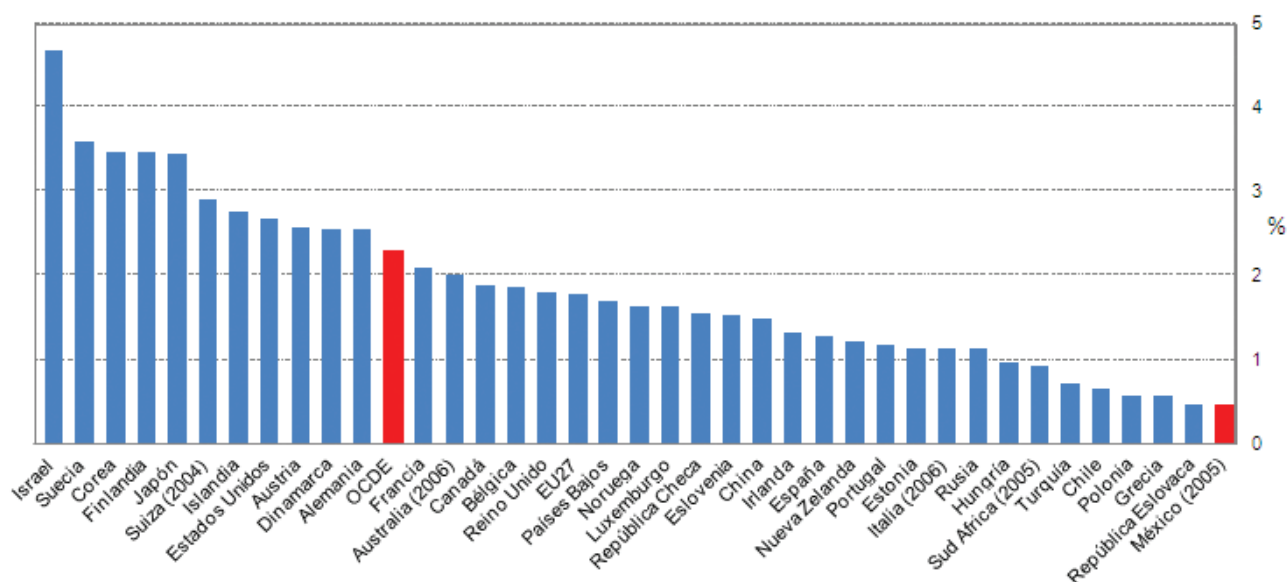
Innovation, and Information and Communication Technologies (ICTs)

Mexico has underinvested in science, technology and innovation; and, as a result, its economy's growth potential is low in comparison with other countries. This must improve if Mexico is to reach a level of competitiveness comparable to other emerging economies. According to all available indicators, the overall level of innovation in Mexico is very low, not only in relation to other OECD countries but also compared to the more dynamic emerging economies. Expenditure on research and development (R&D) relative to GDP remains below 0.5%, while the average is above 2% in the OECD area and close to 1.5% in China. Mexico needs to promote development that is more knowledge-based, by exploiting its considerable assets – hubs of excellence in higher education and scientific research, a large number of highly skilled technicians and engineers, an abundant reservoir of entrepreneurs and, above all, its very young population.

Innovation, science and technology

Mexico's low level of innovation can be attributed to a flawed legal framework and to shortcomings in the governance of the innovation system – factors that explain the country's persistently inadequate level of both public and private investment in this area. Competition is still weak in strategic sectors such as telecommunications, energy production and distribution, and transportation. Upgrading skills at all levels and throughout the economy is essential. New technology-based enterprises, and innovative firms in general, need easier access to private financing. Many regulatory barriers still hamper entrepreneurial activity, and problems of corporate governance reduce incentives to innovate.

Intensity of R&D (GERD/GDP), 2007 or latest available year



Note: GERD = Gross expenditure on R&D.

Source: OECD STI Scoreboard, 2009

The OECD therefore recommends an effort to improve the governance of the innovation system, so as to set clear priorities and ensure efficient implementation. The endeavour should target better co-ordination among ministries and agencies responsible for designing and implementing policy; more systematic evaluation, and better mechanisms to ensure that policy design and resource allocation draw on evaluation findings; and



greater decentralization of innovation policy. This should be accompanied by measures to strengthen the institutional, financial and infrastructure capacities of the country's various regions, to enable them to develop and implement their own strategies.

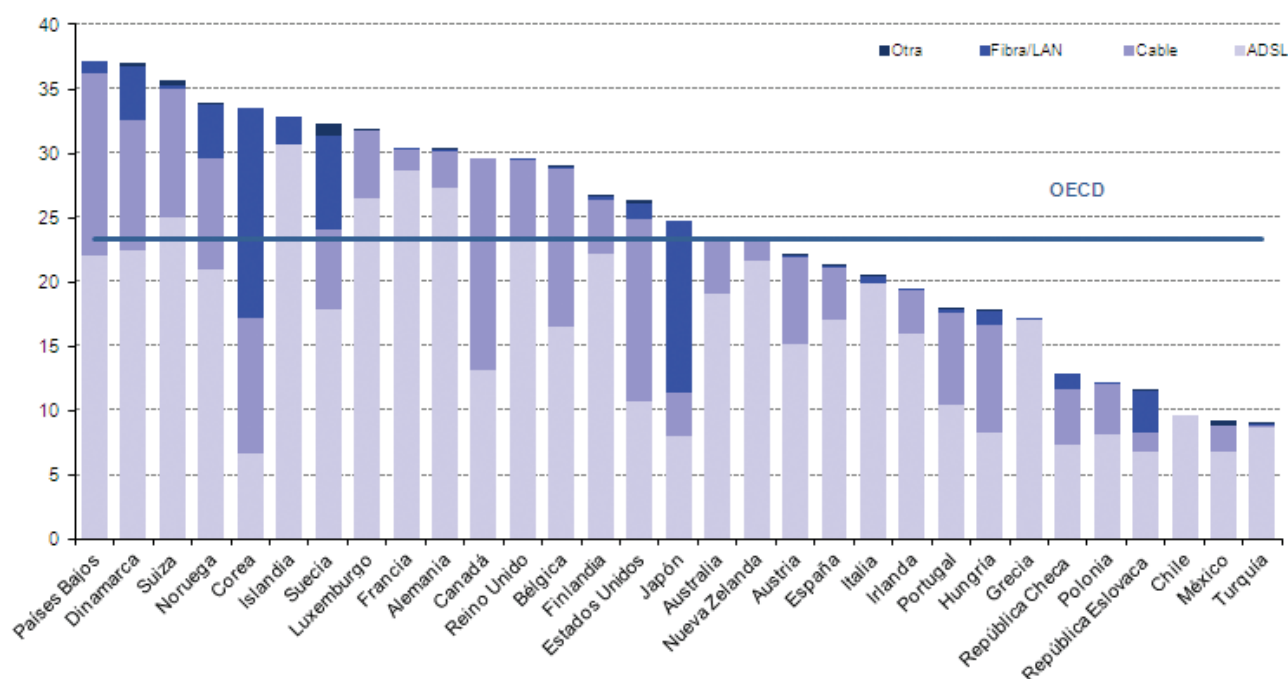
Budgetary funding needs to be increased for R&D investment and innovation, and reforms are needed to make spending more efficient. Direct support, as opposed to tax incentives, should be relied on more heavily; the main direct support regimes should be streamlined and redesigned; and public-private partnership programmes should be scaled up to improve synergies between public and private R&D in priority areas (health, energy, water management, food supply, etc.).

Mexico's telecommunications sector

Mexico's telecommunications sector provides a good illustration of how lack of competition impedes the development of infrastructure for innovation, obstructing the dissemination of innovation throughout the economy and society. Despite improvements in recent years, Mexico still has one of the least developed telecommunications infrastructures in OECD countries; and its telephone prices are among the highest. Reform is needed to increase competition in the sector, and to foster innovation, stimulate growth and increase the economy's competitiveness. The development of ICT infrastructure would particularly benefit SMEs, since these account for about 99% of all enterprises and play a vital role in Mexico's economy. Nonetheless, they suffer from inadequate access to technology and hardly participate in knowledge networks.

Mexico's broadband density is the second lowest in the OECD, and download speeds remain slow owing to the lack of investment in infrastructure. This weakness in the telecommunications sector is closely related to insufficient competition and an investment regime that restricts foreign ownership in the fixed telephony subsector. Moreover, the development of effective competition is hindered by abuse of the legal proceeding of "amparo", which firms employ to block the implementation of decisions made by the telecommunications regulator, COFETEL, and the Federal Competition Commission.

Broadband subscribers per 100 inhabitants, by technology (December 2009)



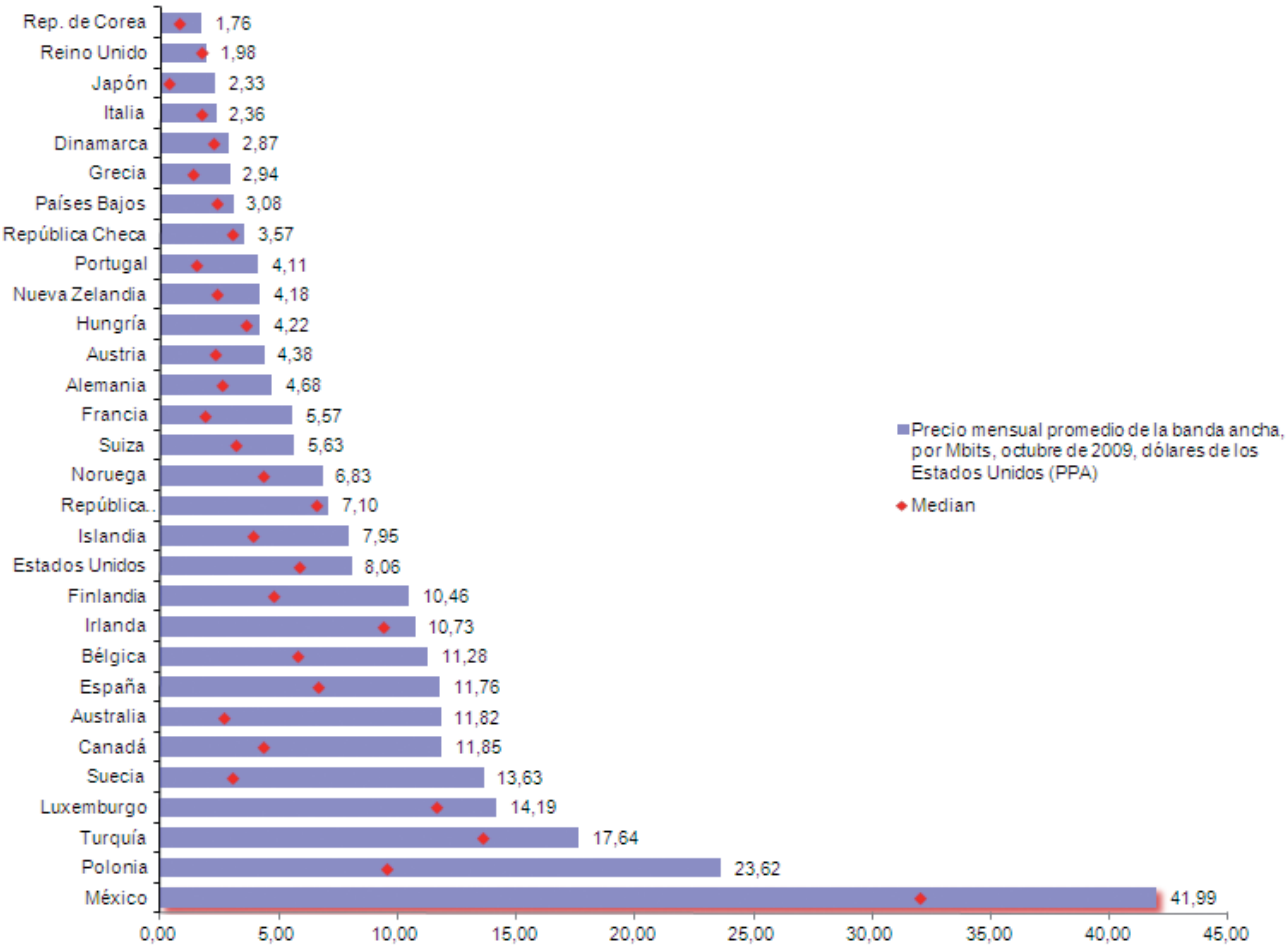
Source: OECD



Mexico's broadband services are among the most expensive in the OECD; and the speeds and services available are inferior to those in other countries. The graph below shows average (and median) prices per megabit per second. Mexicans pay much more than subscribers in other OECD countries.

Regulatory reforms could encourage new firms to enter the market and thus stimulate competition. For example, allowing non-discriminatory third-party access to networks through local loop unbundling (LLU) and by increasing the number of operators in the virtual mobile network could improve price competition very significantly. Interconnection prices in both fixed and mobile networks are high in Mexico. Interconnection occurs at points that are not always technically efficient; and there have been difficulties in enforcing sanctions for interconnection violations. In this context, it is important to give the regulator the power to impose cost-based interconnection rates, and to employ asymmetric regulations where dominance is an issue or where bottlenecks affect essential facilities.

Average Broadband monthly price per advertised MBit/s, October 2009, US PPP



Key OECD Recommendations

- Improve the framework of conditions for innovation by investing in human capital at all levels and throughout the economy.
- Reduce regulatory and financial barriers to entrepreneurial activity, and improve corporate governance in the public sector.



- Improve governance of the innovation system through better co-ordination between relevant ministries and agencies, more systematic evaluation, and the decentralisation of innovation policy.
- Enhance technology uptake by SMEs and their participation in knowledge networks.
- Support investment in R&D and innovation by introducing reforms that make expenditure more efficient, in particular by encouraging public-private partnership in priority areas.
- Foster competition to encourage innovation in all sectors and stimulate the development of essential infrastructure, particularly in network industries.
- Remove foreign investment limits and eliminate ownership restrictions in fixed telecommunications infrastructure and in the service sector; allow non-discriminatory third-party access to networks; and reform the framework governing interconnection.



Environment and Green Growth

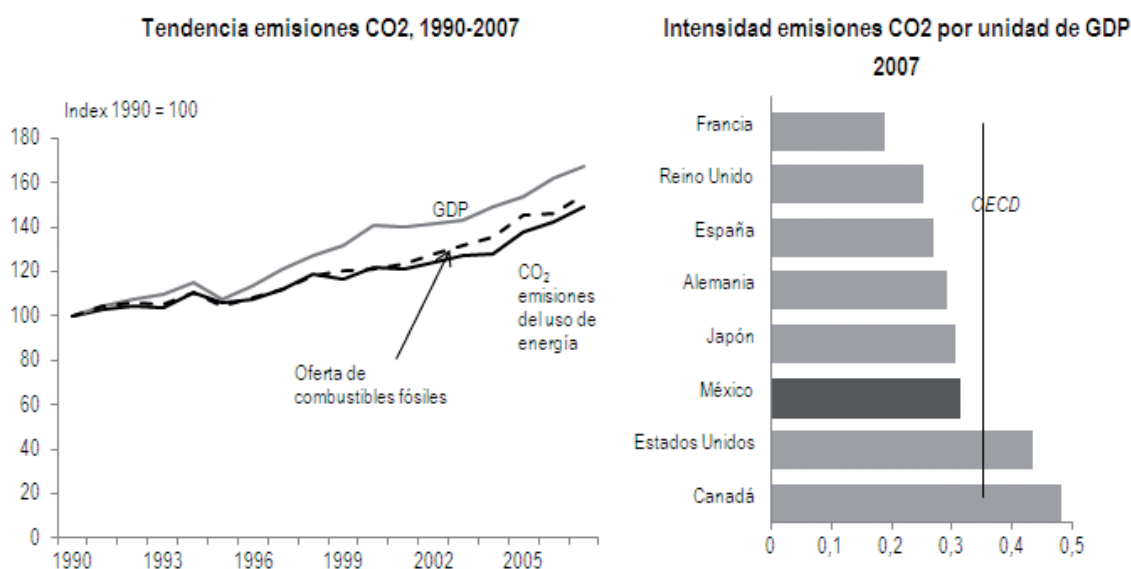
Since the 2003 OECD Environmental Performance Review of Mexico, the country has taken major steps to strengthen its environmental policy and institutional framework. For example, good progress has been made in strengthening measures to control air pollution from mobile sources and by introducing proactive policies on nature conservation and biodiversity. However, Mexico needs to integrate environmental concerns more deeply into national and sectoral policies in order to move towards green growth.

Climate change

Mexico is not listed in Annex I of the United Nations Framework Convention on Climate Change (UNFCCC), and therefore has no emission limits specified under the Kyoto Protocol. Nevertheless, it was one of the first non-Annex I countries to take on an Annex I-like target. In 2008, it announced an aspirational goal to cut national emissions to 50% of 2000 levels by 2050. The country also adopted a Special Climate Change Programme in 2009 that includes a set of actions for achieving an annual reduction in greenhouse gas (GHG) emissions of 51 million tons of carbon dioxide equivalent (CO₂e) (-8%) by 2012. GHG emissions have grown rapidly in recent years, and are now 40% above 1990 levels, largely as a result of road transport and productive activities based on fossil fuels.

Mexico has played a “bridging” role between Annex I and non-Annex I countries, and will host the next Conference of the Parties to the UNFCCC (COP16) in late 2010. Mexico has also supported the Copenhagen Accord with a pledge to reduce GHG emissions by up to 30% compared to business-as-usual by 2020, if it receives adequate financial and technological support from developed countries. The recent (March 2010) bill for a General Law on Climate Change would establish mechanisms to ensure coherent planning and cooperation by sector ministries and levels of government. The bill proposes to set operational rules for a Mexican Green Fund, aimed at channelling national and international finance for mitigation and adaptation measures, and to lay the technical and legal foundations for a national emissions trading scheme to encourage energy efficiency.

Mexico has considered low-cost mitigation strategies and projects in many sectors. Some of these projects are being implemented, but others are not owing to administrative and regulatory barriers.



Source: OECD Environmental Data Compendium and International Energy Agency (IEA).



Green growth

Achieving green growth in Mexico will require more coherent taxation, energy, transport and agriculture policies, as part of the country's Framework for Green Growth development programme. Improving efficiency in state-run electricity and oil industries is key to meeting Mexico's GHG emissions reduction targets. Mexico spends large sums on energy subsidies, and environmental tax revenues are low, which is in part related to gasoline and diesel subsidies. Mexico had negative gasoline and diesel tax revenues in 2008, and, as in 2010, the tax burden was negative. Energy subsidies create incentives to consume more energy and invest less in energy-efficiency; and they are counterproductive for efforts to cut GHG emissions. The international trend is to dismantle such subsidies.

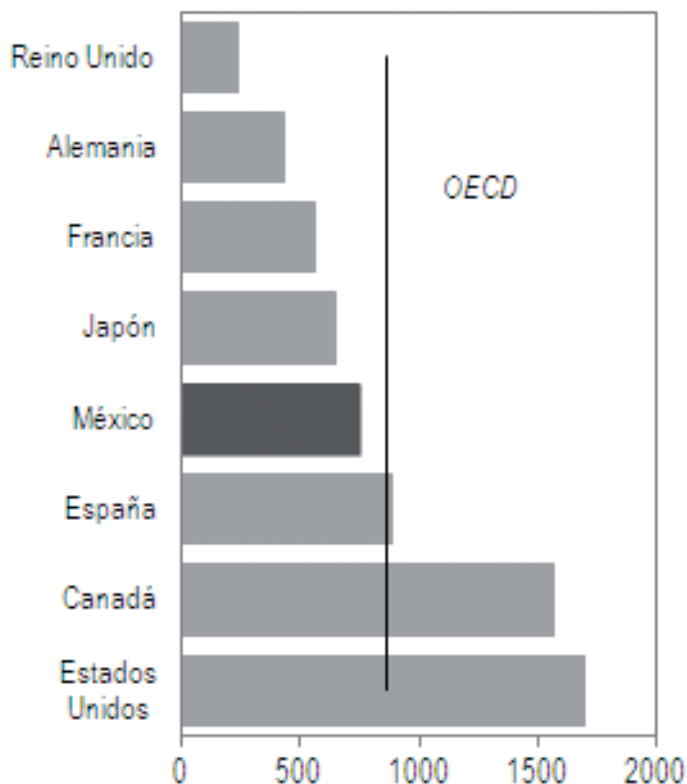
Mexico's policy of keeping gasoline prices constant in real terms and offering subsidies for household energy use should be reviewed, since these measures mainly benefit affluent social groups, whereas direct social transfers have a greater impact on the poor. The removal of environmentally-harmful subsidies would promote more rational resource allocation across the economy while also benefitting the environment. A legal framework fostering private investment in environmentally-friendly economic sectors should also be promoted. Despite efforts to promote coordination, political and economic constraints have thwarted progress in eliminating environmentally-harmful subsidies. For example, agricultural electricity subsidies produce artificially lower prices for pumping irrigation water, which accounts for nearly 80% of the country's water use. This has resulted in an over-exploitation of groundwater, jeopardising aquatic ecosystems and supply to other water users, and increasing supply costs.

Water management

Financing for water management and infrastructure has increased dramatically in Mexico, growing by 137% between 2003 and 2008; and this has helped it to meet the Millennium Development Goal on access to safe drinking water and sanitation. Nonetheless, the country still lags in the enforcement of wastewater discharge regulations and in municipal and industrial wastewater treatment. Although it has a well-developed policy framework for water resource management, policy implementation is uneven, in both institutional and financing terms. Further improvements are needed to increase user participation in water-management financing and cost recovery for irrigation services. The financial sustainability of river-basin management agencies needs to be strengthened through strategic financial plans combining public subsidies with endogenous finance raised from users. To achieve an integrated approach to water policies, better policy coordination is needed between water management and other sectors, in particular agriculture, as well as across the different levels of government.



Freshwater abstraction per capita (m³) (2007 or latest available year).



Source: OECD Environmental Data Compendium.

Nature and biodiversity

The conservation and sustainable use of biodiversity will be a key factor in enabling green growth. As Mexico is one of the world's most biologically diverse countries, its proactive policies in this area set an example for others to follow. Mexico has increased funding for the management of protected areas, which now cover 11.5% of its national territory (compared to 8.6% in 2000). 'Ecological land-use planning' is also spreading outside protected areas. For example, Mexico is one of the few countries in the world with a national programme of payments for hydrological environmental services that provides positive incentives to private and community forest owners for the provision of environmental services. It has also recently introduced subsidies for the buy-back of coastal fishing fleets and the technological conversion of fishing gear to reduce by-catch. However, the number of inspectors has decreased in recent years, and Mexico needs to strengthen enforcement of existing legislation to protect against illegal logging and species trafficking. The application of economic instruments could also be broadened to other areas of natural resource management.

Key OECD recommendations

- Review and revise fiscal instruments from an environmental and economic perspective, particularly to remove environmentally-harmful subsidies that are still in place.
- Expand the use of economic instruments, such as user charges for water and wastewater services, access fees for protected areas and carbon emissions trading.
- Strengthen enforcement and compliance, including prosecution for poaching, illegal logging and wastewater discharges, by measures such as increasing the number of inspectors.



- Improve wastewater treatment (both municipal and industrial), where Mexico lags behind most other OECD countries.
- Enhance the implementation of environmental protection laws.
- Make further progress on the integration of environmental concerns into agriculture, energy, transport and other sectoral policies.



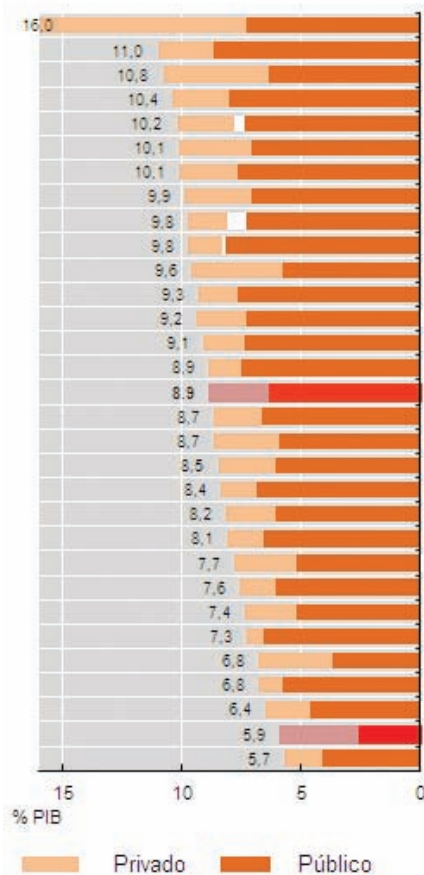
Health

Although Mexico has seen dramatic improvements in life expectancy and a steady decline in infant mortality rates in recent decades, its life expectancy is still the fourth lowest in the OECD. Further progress in improving the country's health services will require the problems faced by rural areas and the poorer states to be addressed.

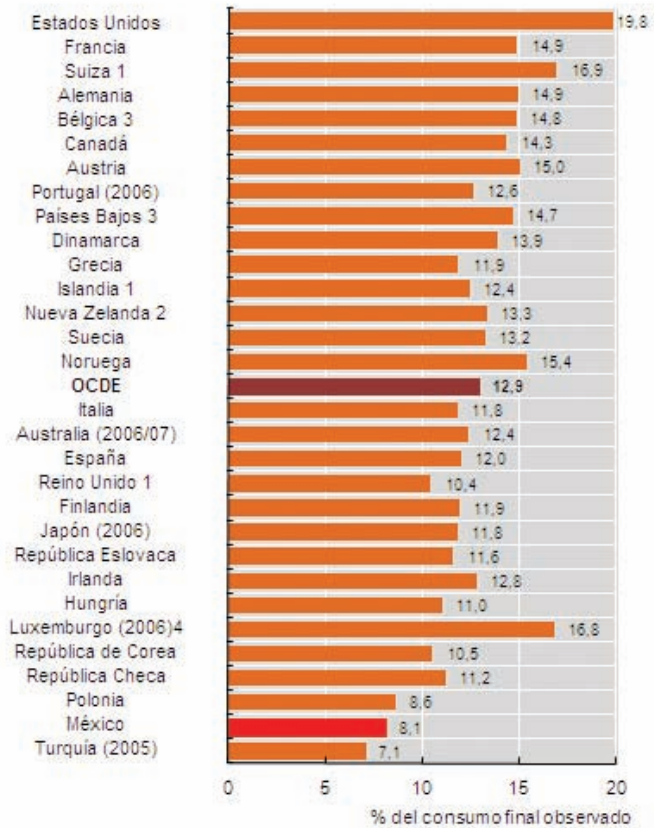
Challenges for Mexico's health system

Mexico has taken innovative steps to improve the performance of its health system. For example, the Seguro Popular programme is being introduced progressively, extending basic health insurance coverage to a growing proportion of the population. The financing mechanism for the programme transfers resources from the richest to the poorest states, thereby reducing differences in the quality of health care across the country. Furthermore, Seguro Popular covers treatment for a limited range of diseases, providing an example for many other countries on how to achieve equitable health outcomes without undermining the system's fiscal sustainability. Nonetheless, this mechanism cannot be expected to solve all of the problems in Mexico's health system; and additional financing needs to be found, and service provision in the public health sector needs to be improved.

Gasto total en salud como proporción del PIB, 2007



Gasto corriente en salud como proporción del consumo de los hogares, 2007



1. Total expenditure on health in both charts. 2. Current expenditure on health in both charts. 3. Health expenditure is for the insured population rather than resident population. 4. Separation of investment expenditure between the public and private sectors not available.

Source: OECD Health Data 2010.



Fragmentation in the health system

Mexico's health system comprises a large and mostly unregulated private sector and a public sector that is fragmented into several vertically-integrated bodies that both provide health care and finance it, each covering different segments of the population. While there is a separate system of state health services for the poor and uninsured, this has historically been underfunded. Prior to the introduction of Seguro Popular, only half of the population had health insurance. A large proportion of health spending in Mexico comes from the private sector (over 50% of total health spending in 2008), well above the OECD average of around 29%. Among OECD countries, only the United States has similarly low levels of public funding.

Health expenditure also needs to be targeted more effectively. Public financing per capita has been inversely correlated with indicators of need, such as infant mortality, as well as with the neediest geographical areas. As a consequence, access to health care has been very uneven across the population. Poor-quality health care stems partly from an insufficient number of doctors and hospital beds. Despite a large increase in the supply of health-care professionals since 1990, in 2008 Mexico had two doctors and 1.6 hospital beds per 1000 people, well below the corresponding OECD averages of 3.2 doctors and 3.6 beds.

Access and affordable coverage

The voluntary health insurance scheme, Seguro Popular, introduced in 2004, has extended coverage for the poor and uninsured and has grown rapidly since it was first set up. In 2008, 71% of the Mexican population had public health coverage. By August 2010, a total of 37 million Mexicans were estimated to be affiliated to Seguro Popular. The Comisionado Nacional de Protección Social expects coverage to reach 49 million in 2011.

Despite the undoubted success of Seguro Popular, challenges include disparities between Mexican states in their capacity to administer the scheme properly, and persistent difficulties in finding sufficient resources to meet growing demand. Mexico has recently taken steps towards integrating different health-care bodies. For example the Ministry of Health established an integrated health database and developed a common tariff system for all health-coverage bodies; and there is also some joint purchasing of patented medicines across different bodies. Further reforms would improve efficiency in health-system delivery, for example by reforming payment mechanisms to reward high performance and by creating an efficiency-enhancing split between purchasers and providers; or by creating a broad-based health-care system with a single insurance package that applies to everyone.

Emerging health challenges

Mexico needs to improve the effectiveness of its health system to address two especially urgent challenges that are affecting a large and growing sector of the population: obesity and diabetes. Mexico's population is one of the most heavily affected by the global epidemic of obesity that has developed over the past 30 years. It ranks behind the United States as the second fattest nation in the OECD area. Between 2000 and 2006, overweight prevalence increased from 62.1% to 69.9%, while the rate of obesity rose from 23.7% to 30.4% of the adult population. In addition, one in three children is overweight or obese, which ranks Mexico among the countries with the highest child obesity rates in the world.

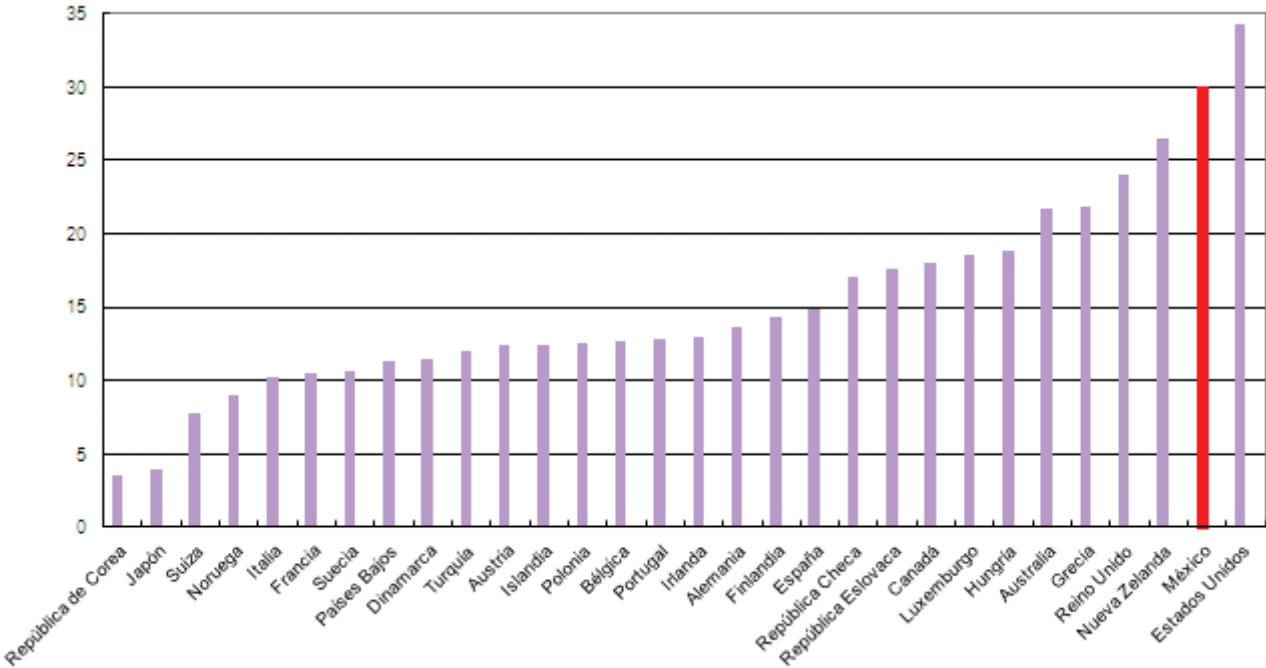
Diabetes, which is the chronic disease most directly linked with obesity, is also spreading rapidly. An estimated 10.8% of Mexicans aged between 20 and 79 has diabetes, one of the highest rates in the OECD region. Type 1 diabetes – the predominant form of the disease in younger age groups – accounts for 10-15% of all cases.

OECD studies show that one of the most effective policies for preventing obesity and diabetes-related diseases is to provide counselling in primary care for at-risk adults. This results in a one-year gain in disability-free life expectancy for every 12 individuals. A package of four effective measures, consisting of a national health



media campaign to promote healthy habits, a compulsory food-labelling programme, regulation of food advertising targeting children, and fiscal measures combining taxes and subsidies based on food quality, could be implemented for less than USD 5 per person.

Obese population aged 15 and above as a percentage of the total population aged 15 and above
(2008 or latest available year)



Note: For Australia, Canada, Czech Republic, Ireland, Japan, Korea, Luxembourg, Mexico, New Zealand and the United States, rates are based on measured, rather than self-reported, body mass index (BMI).

* The statistical data for Israel are supplied by the relevant Israeli authorities and under their responsibility. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

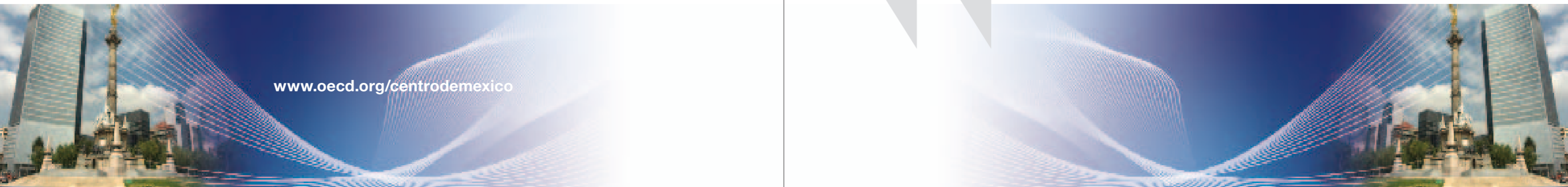
Source: OECD Health Data 2010

Key OECD recommendations

- Ensure adequate funding for the health system by introducing the necessary fiscal reforms.
- Encourage affiliation to the Seguro Popular programme and reduce remaining service access barriers by improving service availability and quality and by progressively expanding the health care package covered.
- Encourage greater efficiency in hospitals and institutional providers by introducing a clearer purchaser-provider split and output-based payment mechanisms.
- Encourage greater productivity in health-care professionals by linking remuneration to efficiency and quality, ensuring that doctors’ private-practice activities do not reduce the availability of public services.



- Promote the quality and cost-effectiveness of health care by expanding disease prevention and health promotion initiatives.
- Improve the governance of the system by strengthening information mechanisms and accountability frameworks for all institutions and by investing in managerial capacity at all levels of the system.



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