

Thank you, Dr. Darwish for your kind invitation.

It is an honour to join this distinguished gathering, as Permanent Representative of Mexico to the OECD, and have the opportunity of exchanging experiences of my country on successful strategies for the implementation of public governance reform that could be of some interest to policy makers in this millenary country and those taking part in the MENA region.

I would like to briefly frame my intervention by outlining Mexico's opening of the economy, which began in the second half of the 1980's. **Then**, I will refer to the recent fiscal and pension system reforms, highlighting the main factors for their adoption by the Mexican Congress. The following observations stem from the assumption that globalisation and societal change are underpinning the need for improved public governance, which can be understood as the **“the formal and informal arrangements that determine how public decisions are made and how public actions are carried out”**.<sup>1</sup>

Mexico and Egypt share similar strategic advantages and challenges ahead. Both countries are home to burgeoning, young populations, who call for public policies to meet rapidly-growing

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<sup>1</sup> OECD Public Governance Committee Mandate.

demands for employment, social security, public services and energy supply. In both economies, the share of services with respect to GDP has increased over the past twenty years, and the percentage of older persons to the total population, gradually, begins to rise. In Latin America, as in the MENA region, **poverty is a drag on competitiveness.**

These circumstances have already favoured a certain degree of mutually beneficial dialogue between our countries. Noteworthy is the visit of Egypt's Minister of Social Solidarity to Mexico, in October 2006, in order to get acquainted with our poverty alleviation programme known as *Opportunities*, or en español, *Oportunidades*. Allow me to elaborate on this programme for a moment. *Oportunidades* was designed to promote investment in education and health among the poor for a limited period of time; its main impact occurs through the accumulation of human capital to help younger generations obtain higher lifetime incomes and break the intergenerational transmission of poverty. It has been extensively evaluated by national and foreign researchers and institutions and is generally considered to have positive results:

- i) per capita food consumption has increased in programme families and the use of preventive health services has risen substantially;

- ii)* a clear reduction in rural infant mortality rates has been observed; and
- iii)* the impact on education has also been significant, reducing failure rates and increasing enrolment in secondary school in particular in rural areas, where enrolment is critically low, while lowering the probability of young children working

The *Oportunidades* programme is clearly progressive, as it transfers about 60% of its benefits to the poorest quintile of the population. Besides having an impact on school enrolment, the programme is contributing to a reduction in the number of poor households and especially a reduction in the depth and severity of poverty. The impact has been particularly striking in rural areas where the proportion of people living in poverty dropped significantly. This illustrates how the programme has been successfully targeted to the most disadvantaged. The favourable results reflect the ability of the authorities to self-correct previous errors and make continuous improvements, i.e. they show the importance of continuous public policy reform, and though *Oportunidades* is a federal programme, it benefits greatly from a bottom-up feedback. Its popularity and broad acceptance facilitate stakeholders' co-operation in other social programmes.

Ultimately, ***Oportunidades*** is directed towards the strengthening of Mexico's social cohesion network, as part of policies seeking to adjust to the challenges of uneven short-term benefits that Mexico faced with the opening of its economy. Like Egypt, Mexico has carried out economic reforms whose scope and pace needed to be compatible with political consensus, as a result of a rational balancing of external and domestic pressures and opportunities. From the mid-1930s until the late 1970s, the Mexican economy grew steadily at an average annual rate of 6 percent. The import-substitution model in Mexico suffered, however, from recurrent trade deficits in the early 1970s, and from an excessive reliance on oil exports to finance balance-of-payments shortfalls. In the early 1980s, Mexico became mired in a spiralling debt crisis. Its external debt burden required the allocation large parts of its foreign exchange proceeds merely to cover interest payments.

It was in this context that Mexico decided to push all-out economic liberalisation and export expansion, culminating in Mexico's entry into the North American Free Trade Agreement in 1994 since, as you know, the United States is by far Mexico's principal trade partner. The impact of these changes on exports and foreign investment has been drastic.<sup>2</sup>

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<sup>2</sup> Kevin J. Middlebrook & Eduardo Zepeda (2003), *Confronting Development*, Stanford University Press, pp. 198-199.

Despite the above progress, **liberalisation did not evolve flawlessly**. Insufficient reserves rendered Mexico's economy very sensitive to shocks. The coming into force of the NAFTA had further increased the import of consumption goods, thereby deepening Mexico's trade and balance-of-payment deficits which were paid for by short-term bonds. The *peso* crisis that started in late 1994, which the *Oportunidades* programme originated from, clearly demonstrated the fragilities of liberal restructuring, and the need for advancing deeper reforms.<sup>3</sup> **The impact that a decade-long reorganisation had on public governance could not be overlooked, since such process of liberalisation had disrupted existing political and economic structures; hence the importance of fostering public governance.**

In the same year of joining NAFTA, 1994, Mexico accessed the OECD, within its strategy to increase its participation in the global economy. It was evident that an urgent need to strengthen Mexican public governance emerged from the increasing international competition; for Mexican policy makers the message was clear: the economy could not be disassociated from public policy. **Therefore, the national policy dialogue was enriched by discussions held in OECD meetings.** The lessons learnt and best practices identified by the Organization served as powerful

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<sup>3</sup> Alex E. Fernández & André Mommen (1996), *Liberalisation in the Developing World*, Routledge, New York.

instruments to evaluate and compare our economic development to that of OECD members.

However, public governance best practices are not always feasible. And **desirable public governance reforms are rarely possible**. Potential reforms demand stakeholders and government work together. In this context, let me now refer to fiscal process of reform in Mexico.

As in other OECD countries, Mexico's tax administration faces many challenges: there are the day-to-day requirements of helping to achieve budget revenue targets and providing adequate services to taxpayers, against a backdrop of significant and diverse non-compliance issues, and the on-going need to develop a competent and trustworthy workforce, information technology services, and internal financial management. There is a considerable number of individuals who should be, but are not, registered for tax purposes and overall revenue leakage is substantial. Tax revenue collection is seriously affected by weak compliance, even in the formal sector. These issues might be similar to those being tackled by recent reforms in Egypt, which among other objectives simplified tax procedures, and broadened the tax base, strengthening enforcement, while encouraging investment, and modernising the tax administration.

In this sense, the Mexican government launched a **Public Finance Reform** proposal, which was adopted by the Mexican Congress in September 2007.<sup>4</sup> It included some measures to facilitate voluntary compliance to tax obligations as well as measures aimed at reducing tax evasion and taxing the informal sector. It also pursued other goals:

- a simplification of the personal income tax regime;
- the introduction of a new tax on cash deposits, raising the perception of fairness in taxation;
- an institutional structure that guarantees result-oriented spending;
- re-adjustments of Federal-State Revenue Sharing formulas, as well as federal sales tax on diesel and petrol; and
- the introduction of a flat rate business tax, which is an income tax on firms and professional activities to be applied on the firms' revenues from the sale of goods, the provision of services and the temporary grant for the use of goods, after deduction of capital spending.

The reform required a comprehensive technical analysis, as well as a **careful political weighing of the different alternatives to ensure full support from all stakeholders.**

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<sup>4</sup> Extract from Minister Carstens' speech on occasion of the official dinner held at the Ministry of Finance of France (Bercy), on June 4<sup>th</sup>, 2008, to discuss "The political Economy of Reform".

Another key element was the proposal's label. Interestingly, in a country where avenues are named after constitutional reforms, the proposal was never called a *tax reform*, so as to avoid producing negative reactions. More important was the Finance Ministry's direct and early contact with States, the equivalent of Egyptian Governorates, as well as with opposition leaders and other stakeholders. They all had a chance to express their views from the very start, and the Ministry of Finance made sure that they were taken into account during the drafting of the proposal.

There was also a concerted effort to raise legislators' awareness of Mexico's low tax-take, particularly when compared with other economies of similar size. Problems of revenue volatility generated by the instability in international oil prices were also thoroughly explained to them.

Furthermore, even though a modification to the state-owned oil company's fiscal regime was not initially planned as a component of the Public Finance Reform; legislators campaigned for its inclusion. The proposal, which focused on diminishing PEMEX tax burden, resulted as well in additional resources now allocated to energy research and development.

Lastly, I would like to emphasise Finance Minister Agustín Carstens' **leadership** in designing, negotiating and drafting the

final proposal. His leadership was instrumental to engage stakeholders throughout a chain of comprehensive consultations and briefing sessions. This gave him high credibility among policymakers.

The **second reform I will briefly refer to** is related to the pension system for federal employees (known as the **ISSSTE** system). By 2001, it was evident that restructuring this system was not only necessary, but “key to the sustainability of fiscal efforts”.<sup>5</sup> The ISSSTE reform, adopted in March 2007, aimed at fostering efficiency and competitiveness while ensuring the alignment of issues such as labour market mobility, equity and incentive structures across the system. By tightening eligibility rules and the generosity of benefits, the ISSSTE reform significantly reduces the federal government’s pension liabilities, and thus helping the present net value of contingent liabilities decline from 57% to around 35% of GDP in the long run.

Initially the reform sparked considerable opposition among public union sectors and opposition parties, who feared that it was a prelude to privatising health care. Therefore, the government dedicated considerable efforts to sell the reform by carrying out consultations with stakeholders, and incorporating their concerns into the proposal. Public debate did not question the need for a

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<sup>5</sup> Marcelo M. Giugale (2001), *Mexico: A Comprehensive Development Agenda*, p. 231.

reformed ISSSTE, but the cost of ensuring the system's long-term financial viability.

Perhaps one of the most important elements that facilitated the reform was the decision to give the option for workers under the old system to keep their benefits. If a worker chooses to join the new system, however, he or she receives government bonds. Moreover, the government constantly stressed the fact that all pensions were going to be being duly paid despite the burden placed on government finances, and its commitment to uphold future payments. A massive information campaign made it possible to convince stakeholders of the negative consequences that would result from failure to reform the pension system in the long term in order to secure their support for the reform.

Furthermore, the government launched a campaign to improve healthcare and other facilities provided by the ISSSTE to over 10.3 million beneficiaries. The ISSSTE renovated medical equipment with cutting-edge technology, and enhanced highly-specialised services. Clinics and family medicine units were improved, while a programme of appointment scheduling via telephone or Internet was set up. Such improvements were widely publicised during the proposal's public scrutiny.

Political **timing** was also crucial. This reform had been tried before during the 2006 elections, with no success. It was re-launched in 2007 under President Felipe Calderón's personal leadership, just after he took office, as public opinion was eager to welcome firm and deep reforms.

Summing up, some elements common to both reforms could be highlighted:

- Learning from international public policy best practices;
- Ensuring technical soundness;
- Assessing its political viability;
- Choosing the right time to launch it;
- Appointing a proposal's leader at the highest level;
- Starting direct consultation early on;
- Compromising;
- Raising public and policy makers' awareness on related subjects; and
- Triggering a sound public debate.

There is no magic formula to have a reform adopted, but it could be said that consensual reforms have better chances of being approved and implemented.

Finally, I would like to thank the Egyptian authorities, whose successful introduction of sales tax and property tax reforms could be of great interest to Mexican policymakers. Please be assured of the willingness and readiness of President Felipe Calderón's Administration to explore and deepen our communication and co-operation channels. We also appreciate and welcome the work carried out by the region and the OECD through the MENA programme, which sets the standards for OECD engagement with other regions.

Thank you.