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A New Vision for Mexico 2042: Achieving Prosperity for All

A Study by

Centennial Group

Discussion Paper

Emerging Markets Forum

A nonprofit initiative of the Centennial Group

Bringing people together to accelerate growth and well-being in emerging markets

A New Vision for Mexico 2042: Achieving Prosperity for All

Introduction

It has been almost thirty years since the debt crisis that Mexico confronted in 1982. It was followed by a period where the Mexican economy went through crises, stagnation, contraction, and growth. From a macroeconomic perspective, the years after 1995 were the most stable in recent Mexican economic history. The underlying policies were implemented by a sophisticated technocracy, helped by the integration of Mexico in the North America Free Trade Arrangement (NAFTA) and a determined effort to open the country to the rest of the world.

A solid economic performance, in the context of sustained world economic expansion, gave Mexicans an unwarranted sense of security and complacency. It thus became increasingly difficult to push a reasonable structural reform agenda; public finances followed a shortsighted path based on a dwindling pool of oil; tensions among different sectors of society increased; technology, education, and infrastructure improved at a snail-like pace, if at all; and total factor productivity remained stagnant. As a result, Mexico fell and has remained behind peer emerging economies.

Mexico's economic climate has been further affected in 2009 by the Great Recession, as it experienced the largest decline in GDP in its recent history and among major Latin American economies. Since then, the economy has recovered to pre-recession levels, but remains fragile, even with a sound but small financial sector almost intact. However, oil output and related revenues continue falling; the prospects of public finances, in shape today, do not seem fit for the challenges of the future; investment and savings are low; education remains below par; and factor productivity has not increased. Thus, there are serious questions about the sustainability and growth prospects of the Mexican economy.

As Mexico's path towards prosperity became increasingly disappointing, it resulted in large emigration. The Mexican Diaspora's remittances have been an important factor in reducing income disparities, but they clearly are not the solution to the country's difficulties. Neither does the high reliance on NAFTA help. The country has fallen into the Middle Income Trap (see below), successful in breaking away from poverty and then cursed in a state of mediocre stagnation.

Further complicating Mexico's path to sustained and inclusive prosperity is the pervasive presence of drug trafficking and crime. Violent gangs have been involved in major turf wars and an open conflict with the Mexican government. The wars have been centered in a few geographic areas, but have damaged confidence in the capacity of the government to operate effectively. Some analysts, most likely in an exaggerated fashion, predict an impending disaster and even talk about a "failed" state.

The growing population has placed the country's natural resources under stress, including with respect to the use of water, the implications of a highly urbanized society, and limits to cultivable land. But even so, the pollution imprint and the degree of environmental degradation do not seem to be of the same gravity as in many other places, including in Asia.

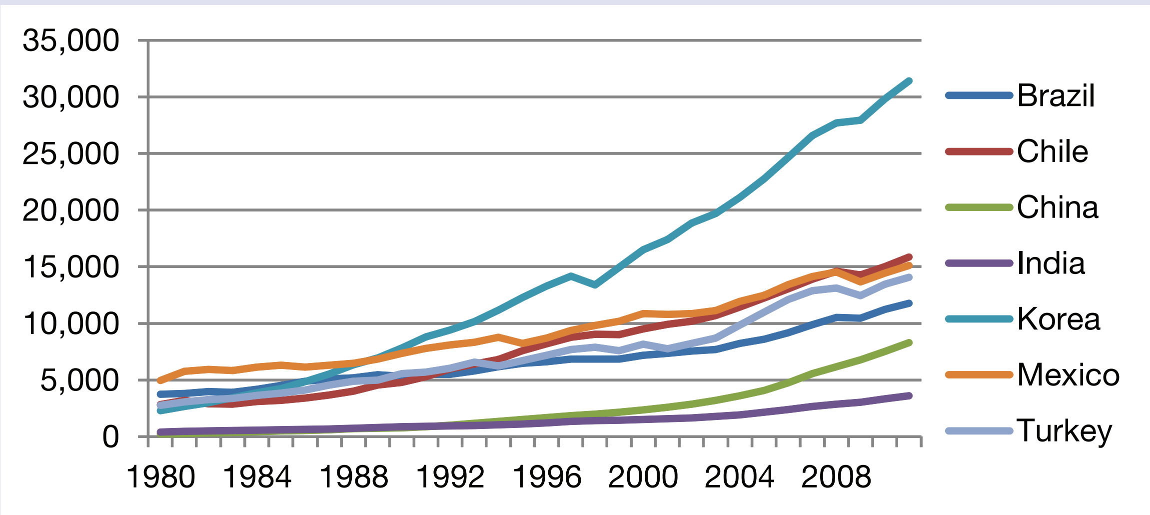
1 The study underlying this paper was prepared by a team of experts consisting of Drew Arnold, Mahmood Ayub, José Fajgenbaum, Hervé Ferhani, Harinder Kohli, Harpaul Alberto Kohli, Claudio Loser, Anil Sood, and Aaron Szyf (all of Centennial Group), Alejandro Hope, Manuel Molano, Juan Pardinas and Roberto Newell (associated to IMCO), Edna Jaime (Mexico Evalua), Jeff Puryear, and Alexandra Solano (Inter-American Dialogue), Lucrecia Santibañez (RAND Corporation), and Carlos Malamud (Real Instituto Elcano). The team benefitted from the able technical support of Kathryn Grober and Charlotte Hess of Centennial Group. Centennial Group International has prepared this study on the basis of the methodology developed for and the experience gained from five similar studies carried out by the Group over the past two and half years: *India 2039—An affluent Society in One Generation*; *Latin America 2040—Breaking Away from Complacency: An Agenda for Resurgence*; *A Resilient Asia Amidst Global Financial Crisis: from Crisis Management to Global Leadership*; *The New Resilience of Emerging Market Economies*; and *Asia 2050: Realizing the Asian Century*. All these studies have been published.

The study underlying this report reviews the possible reasons why Mexico fell into the Middle Income Trap. It formulates strategies to extricate the country from this trap, over the next several *Sexenios*. The study's basic premise is to present fundamental reforms for Mexico to achieve higher, sustained, and more inclusive economic growth than it has in the past thirty years. The resiliency of the Mexican people would help the country go successfully through the transition to a fast growing economy. It should be clear that some issues are cross-cutting, among them informality, energy, vested interests, education, and drug-related crime, and cannot be treated in isolation within one section alone. Also, it is practically impossible to cover all aspects of Mexican society that require reform. However, the idea is to provide an ambitious but doable roadmap for Mexico to attain prosperity and inclusion in the next thirty years.

Mexico in the Middle Income Trap

The economic trajectory of a steadily growing country would be a strongly upward line, with possible breaks due to international events, like a global or regional and cyclical crisis. That is the experience of South Korea and this is also emerging in China and India (Figure 1). But many middle-income countries, such as Mexico, do not follow this pattern. Short periods of growth are followed by periods of decline. GDP per capita fluctuates with little upward trend. This is what is referred to as the ***Middle Income Trap***—a situation when a country is unable to compete with low income low wage economies in manufacturing, and unable to compete with advanced economies in high skill innovation. Few countries sustain high growth for more than a generation, and even fewer continue their high growth rates once they reach middle income status. Only 13 countries sustained growth

Figure 1 **Per capita income (US$ 2010, PPP)**



Source: International Monetary Fund, World Economic Outlook Database, April 2011 of more than 7 percent for at least 25 years in the postwar period.[2] These countries have five common characteristics: (1) Openness to the global economy in knowledge and trade; (2) Macro-economic stability; (3) "Future orientation", with high rates of savings and investment; (4) Reliance on markets and market-based prices to allocate resources; and (5) Leadership committed to growth and inclusion with a reasonable capacity for administration. These success factors are necessary—*but not sufficient*—for continued growth. Reaching incomes associated with the advanced countries is uncommon: only a few of the high-growth countries did so. It is much more common for growth to slow markedly when reaching middle-income status, as was the case of many Latin American and Middle Eastern countries.

In general, these countries break away from low levels of income. Wages start to increase, and the low-wage labor-intensive manufacturing for export model does not work well, and the countries slow down and seem trapped. At the same time, middle-income countries often do not have conditions to grow through major innovations, like affluent countries. Caught between these two groups, middle-income countries can become trapped without a viable high-growth strategy. Mexico falls in this category.

A historical perspective

Mexico's performance has fluctuated enormously over the period of its existence, even before its independence. Over the course of a century and a half, Mexico grew at a faster rate than the global economy. Based on estimates made by Maddison[3], Mexico's share of world GDP rose during the first three quarters of the 20th Century and reached a peak of 1.7 percent of world GDP in 1973, with GDP per-capita exceeding the world average by some 50 percent.[4] Starting in the 1980s, overall GDP and per capita GDP growth started to slow and lagged the rest of the world (Figure 2). Per capita income is reasonably high, the country benefitted from the major booms in oil prices (but suffered from their declines), and many individuals have been lifted from abject poverty in the last decade and a half. Mexico opened to international trade after years of isolation, and reaped some of the benefits of a globalizing world. Capital inflows were closely associated with these developments. However, the gains were concentrated in areas of traditional comparative advantage and not in new and more dynamic and profitable areas. The degree of openness is the highest among the larger countries of the region, but lags behind the more dynamic emerging economies. While economic growth seems to have increased after Mexico was hit by serious financial crises in 1994–95 and more recently in 2009, current policies have kept economic growth at less than 3% a year. An acceleration of growth as proposed here, to about 5% cannot be achieved within the current strategic framework and policies, and historical levels of savings and investment.

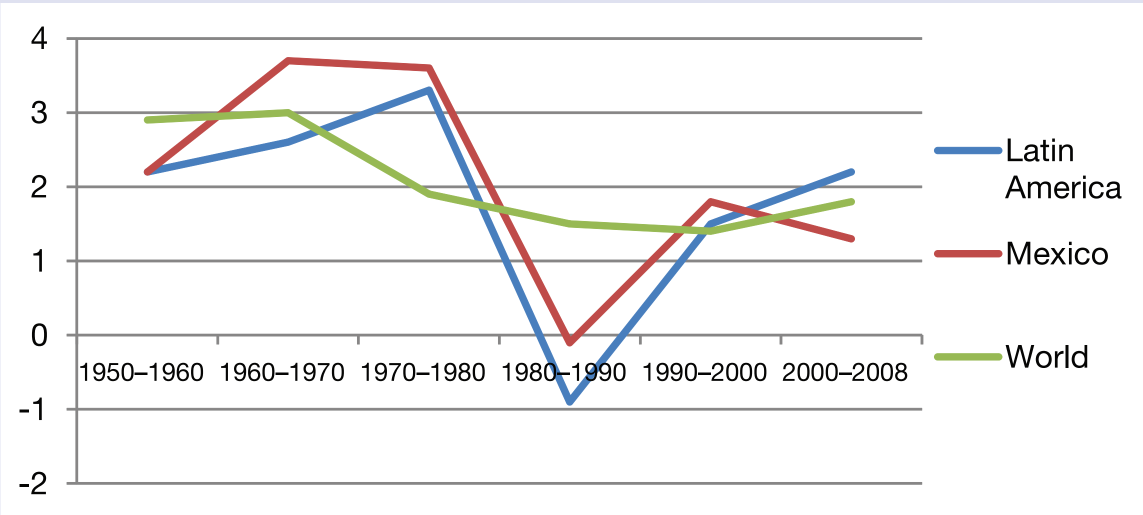
Where does Mexico stand with respect to the world community?

In today's competitive environment, Mexico cannot compare its performance to the past or some ideal target. As many countries in the continent and in Africa, Asia, and Europe discovered, they cannot stand still or view themselves in an inward-looking fashion. Thus Mexico will need to compare itself

2 Commission on Growth and Development's review of growth in developing countries.
3 Maddison A. 2004 The World Economy, A Millennial perspective.

4 These numbers are subject to considerable uncertainty and are based on longer term historical studies, like those of A. Maddison. Estimates based on current dollars, as most of the estimates made for the last forty years may give a somewhat smaller ratio of per capita GDP for Mexico compared to the rest of the world.

Figure 2 | Per capita income growth rates: Mexico, Latin America and the World (average percentage change, over each period)



Source: International Monetary Fund, World Economic Outlook Database, April 2011

with its peers and competitors, or it will become a frustrated spectator in the world scene.

Clearly, growth potential and competitiveness are closely related to performance with respect to total factor productivity (TFP). Regarding the level of TFP, Mexico remains ahead of countries like China and India as well as developing East Asia. However, growth in TFP is very low, with negative growth in the last 30 years, although this value is in part the effect of 2009. In large part, the low levels of savings and investment are a consequence of pervasive informality, which reflects weak institutions, and an inefficient tax and benefit system in the public sector.

Education is also a critical component of productivity growth. At present, Mexico is neither producing nor attracting the human capital it needs to be more productive. Mexico does poorly in terms of schooling. Overall, Mexico ranks 29th in terms of primary education enrolment out of 139 countries in the Global Competitiveness Report 2010–11, but 120th in terms of the quality of the educational system and primary education, and 128th in terms of math and science, for a 66th position overall.

Mexico has few high-quality universities. Only one Mexican university (the Universidad Nacional Autónoma de México—UNAM) ranks among the top 200 universities internationally. There are high quality Mexican institutions that are excellent but too specialized to qualify as universities and are not included in the rankings. Enrolment in tertiary education in Mexico is low, when compared to other countries in Latin America (e.g., the contrast with Chile is striking). Only about one-sixth of Mexico's labor force has a university degree, and the quality of graduates is very poor.

The low rates of saving and investment have also limited Mexico's growth potential. Savings and Investment as a proportion of GDP exceed the levels in the US and many other countries in Latin America. However, given its relatively low per capita growth, and the serious gap in total factor productivity, these levels are clearly inadequate. At about 23% of GDP, investment is one half of the levels in China, and about 10 percentage points lower than India and the levels of the NICs at the time of their breakaway from middle income status. The gaps are even larger in the case of savings.

Mexico spends a relatively low amount on R&D (about 0.5 percent of GDP, compared with 1 percent in Brazil, 2.7 percent in the US, and 3.2 percent in Korea), and with a very low number of researchers in R&D and a low number of science and engineering journal articles published. Private sector spending in R&D also ranks low, and the country scores very low in terms of Intellectual Property Protection.

Mexico's current infrastructure lags far behind its potential. Its infrastructure ranking of 69 out of 133 in WEF's Infrastructure Competitiveness Index and 50 out of 57 in IMD's World Competitiveness Index highlights this gap. An increase in the level of spending in infrastructure (excluding energy) from under 2% of GDP to 3.5% will be necessary.

The Mexican banking system is well-capitalized and liquid. It has a high concentration—7 out of 41 banks control more than 80% of assets. This is worrisome in terms of competition, but concentration does not seem to seek "rent extraction" through high interest rates. Nevertheless, other financial costs are high and removing barriers to entry could lower them. More importantly, the financial system is very small even with financial liberalization. In particular, this is due to the weakness of property rights protection, and a large informal sector. It is also the result of high volatility, a factor that has been sharply reduced more recently but still is too fresh in the memory of entrepreneurs and investors.

Mexico's indicators in key indices show some other shortcomings. The general observation on Mexico's business climate seems to be that it is unremarkable for a country at its stage of development. The provision of inputs is adequate, but institutional weaknesses and rigidities move Mexico into lower rankings. Notably, these weaknesses relate to the inefficiency of government bureaucracies, the perceived corruption of public officials, the poor protection of property, and a complex tax system. A critical factor is the lack of domestic competition. Mexico is characterized by monopolies or highly concentrated markets that limit competition in many sectors.

It is not surprising that Mexico scores poorly on the Global Competitive Index, ranking 66th, out of 138, well behind the US (4), Korea (22), China (27), Chile (30), Spain (42), India (51), and Brazil (58), and lagging other regions, like the Advanced Economies (12), the NICs (17), and Developing Asia (38), and only marginally better than Latin America overall (69).

Mexico's economy has benefited from a demographic boost, reflected in a substantial increase in working class population relative to total population through 2035. Declining mortality rates in the 1980–90s have led to this one-time population boost, and lower fertility rates in the decades that followed have created a situation in which this larger population will have fewer dependents to support. This "demographic dividend" should provide a welcome tailwind for economic growth and living standards, but also entails a rapidly ageing population in the next thirty to forty years. This is a major long-term challenge, as the dependency ratio is going to increase significantly.

Finally, increases in education, government programs such as Oportunidades, the very large flows of remittances from Mexicans abroad, and changes in demographic conditions help explain a sharp reduction in the incidence of poverty. However, income distribution remains extremely unequal, and constitutes a serious challenge for the country. Poverty incidence declined by 28 percent over 20 years, and now afflicts a (still high) one third of the population from almost one half in the 1980s; indigence has decline even faster. Still Mexico's GINI coefficient, measuring inequality, has declined only marginally (4 percent) and remains high by international standards, below Brazil, Chile and Colombia, but higher than any other OECD country, other than Chile.

A framework for economic revival and sustained prosperity

Mexico needs to grow more rapidly than in the past to break away from the Middle Income Trap. It is being left behind by other dynamic emerging economies. The goal for policy makers should be to achieve prosperity for all and restore Mexico's relevance within the group of Emerging Economies and on the global stage. To this end, it needs to formulate and implement a comprehensive plan of action to be implemented over the next four years, with a perspective that goes beyond the usual six years of the political cycle. If Mexico were to pursue such a forward-looking and reformist approach, it can become a converger, accelerate growth by some 2 percentage points a year, and in thirty years enjoy a per capita income about three and one half times current levels. This increase would be well ahead of the increase in world per capita income and ahead of those of most countries in Latin America.

A vision of Mexico in 30 years

What is the Mexico we envision in five *Sexenios*? We see a country of opportunity, prosperity, and personal safety and low crime, where the population has much higher living standards, with dignity, inclusion, and progress, and its people excel in learning and innovation, reflecting their own preferences. This is not a fantasy that can be discarded as unrealistic. On the other hand, it is not a certainty resulting from coincidence, the mere passage of time, or the right granted by a superior force. A better Mexico will be the result of hard work, devotion, and a single-minded pursuit of results that would make Mexico a beacon in the world. The outcome will be affected by forces beyond its control and its borders, but the final outcome will only come from Mexico itself.

Mexico in thirty years can be a country with an average income more than three times what it is today—the equivalent of the current income of Germany and France, and somewhat below the per-capita income of the US. This would provide for enormous opportunities in the context of a competitive economy. Through education, and other means of inclusion, an efficient and equitable tax and public expenditure system, and greater integration to the world, income would be distributed differently. The structure of the economy, with the right incentives, would allow those Mexicans with the willingness and aptitude to excel intellectually and financially to do so. The 20 percent lower income population could see a fivefold increase in income or even more than that, while the better-placed could see almost a tripling of their average income, in the context of better institutions.

Smaller by choice, and better educated by increased opportunity, families would see much higher living conditions, supported by a well-functioning infrastructure and a competitive domestic economy. Children and young men and women would attend good schools, be they private or public, learning from world class educators, and with rising numbers of people from abroad benefitting from better universities. Investments and reforms would help improve health, and make the environment more conducive to a better life. Crime would be reduced to levels comparable to advanced countries, with a good and pragmatic system of cooperation with neighboring countries.

Graduates would be able to exercise their initiative as professionals, business people or as part of small, medium and large corporations, with good access to credit, be it through banks or alternative forms of financing. Older citizens would be able to have the peace of mind coming from a retirement pension system that thrives within a growing financial system, in a stable macroeconomic environment.

The government would play a major role in monitoring, in an intelligent and prudent manner, the operation of the private and public sectors and would manage a credible justice and security system. Mexico would play a major role in establishing best practices with respect to state and corporate governance, including on application of the law and respect for contracts, and work diligently with the international community to share its experience.

Relations with the rest of the world would be based on a position of strength, and with trade and investment that goes well beyond a well-functioning NAFTA. Mexico would balance its position with the two most powerful countries in the world, China and the US. For this purpose, Mexico would take greater advantage of its market potential and location, and continue its deep commitment to multilateralism and its role as a valuable member of the international community.

A plan of action

In order to raise the rate of GDP growth, Mexico will need to move from its solid post-Great Recession rebound into strong and sustained economic growth with an accompanying emphasis on inclusion and equality. This will have to rest on several imperatives: policies will need to introduce significant changes in the fiscal framework, and implement major shifts in education, adoption of new technologies and enhancing infrastructure, and good governance. In addition, reforms will need to aim at promoting higher savings and Investment ratios, by improving the business climate and increasing competition, and strengthening Mexico's links with the rest of the world, including with fast growing Asia. The degree of policy implementation will determine where the Mexican economy will fall within the specified range of possible outcomes. The reforms would fall into six groups, as discussed here, at the core of the recommended reform agenda.

Build a competitive economy on the foundation of strong human capital development and access to competitive energy, infrastructure and finance

A competitive economy is the key to faster growth in Mexico. A competitive economy requires strong human capital, competitive physical inputs, and access to finance. On the human capital front, Mexico should pursue quality learning at all levels and for all segments of its society as a national objective. Good education may be the single most powerful tool available to increase economic growth, enhance competitiveness, and promote inclusion. Improved higher education with a greater emphasis on applied science, including engineering, should be provided in the context of the development of a spirit of entrepreneurship and innovation. On the physical front, fundamental reforms are needed in energy (particularly petroleum, gas, and electricity) as well as much higher public and private investment in infrastructure (including for information and communication technology). Deepening financial intermediation and opening up the financial sector to foster competition and better serve currently underserved segments, such as SMEs, would also be a key to increase productivity and competitiveness.

Enhance competitiveness through major improvements in the Business Environment

A competitive Mexican economy can best thrive in a business environment that provides the right incentives for competitiveness. To deal with this problem, it is crucial to understand that there are **three economic Mexicos**, without geographic,

Figure 3 **A new vision for Mexico 2042: Achieving prosperity for all**

Source: Authors' illustration

or class, or income distinction. The first is a Mexico under old-fashioned government control, as was the trend of Latin America in the 1950s and 60s (old political formats, the teachers' union, Pemex, CFE, inflexible labor and agricultural land regulations). The second is crony-capitalism Mexico, of privatized businesses that extract rents from consumers, or of interest groups without foreign competition. The third is modern, progressive Mexico. It bloomed with NAFTA and still has a long way to go, and still has to pay rent to the other two Mexicos. The three Mexicos have varying degrees of informality, corruption, and criminality, which are helped by weak institutions that cannot keep state-controlled and crony Mexico at bay and foster the growth of progressive Mexico.

Mexico's competitiveness can only be achieved by breaking down the hold of public monopolies (such as PEMEX and Comision Federal de Electricidad (CFE)), private monopolies (e.g., in telecommunications) and vested interests (such as SNTE in the education sector). Privatization may be required in selected sectors. Domestic measures need to be complemented by further opening up Mexico's economy to trade and investment with the region and the rest of the world. A vibrant SME sector could be another integral element of a competitive Mexican economy and can be encouraged through reforms to make it easier to do business and to attract more "informal" Mexican enterprises into the more productive formal sector. Rapid growth does not occur in a vacuum, but results from an institutional environment that creates incentives for productivity and efficiency and which provides social security benefits to all workers regardless of their labor status.

Implement policies aimed at reducing disparities and fostering inclusion

Mexico's growth performance over the past three decades has been lackluster, compared to other emerging economies, in part because of inequalities and lack of inclusion. Mexico's many rent-seeking activities, powerful monopolies and unions, and poor legislation or its implementation constitute the main obstacle to both faster growth and reduced inequality. The persistence of inequality also can trigger social and political tensions and even lead to conflict and to lower growth. Thus, economic strategies for the future cannot succeed without a commitment to equality of opportunity and inclusion.

An important form of exclusion is the existence of the informal sector, with its limited access to productivity-enhancing technologies, financing and training, and poor protection of property rights. The source of the problem is poor legislation, which forces high non-wage labor costs, poorly designed tax and social security systems, and poor credit risks perceived by creditors. For many, this is aggravated by regional and ethnic disparities, as well as gender discrimination.

These factors explain why Mexico is highly unequal, even though conditions have improved in recent years as a result of the impact of NAFTA, remittances, and the effect of the Progresa/Oportunidades program on poorer families. But to maintain the positive trend in reducing income inequality, it will be important for the government to take a more proactive approach: give high priority to addressing the unequal quality of basic education; improve access to secondary and higher education, justice, information, and finance; put the informal and formal sector on a more equal footing; and deal with issues of regional disparities, and in a few decades, ageing.

Ensure a predictable, stable macroeconomic environment

Mexico has achieved an important degree of macroeconomic stability. However, it can only persist—as it should—in the context of a comprehensive fiscal reform, aimed at improving the efficiency and yield of the non-oil tax system, and at enhancing the level and composition of public expenditures in order to lift the constraints to growth and realize lasting poverty reduction. Within these general principles, the adoption of structural fiscal targets would allow for larger deficits and higher expenditures in times of recession and opposite corrections in times of prosperity. The resulting more stable macroeconomic environment will permit the private sector better plan its business decisions, with a positive impact on growth potential. The establishment of an intergenerational oil fund, to the extent that oil remains important, would provide critical support to the implementation of the structural fiscal rule and, more fundamentally, would help limit the adverse consequences that would arise from an accelerated use of oil revenue stemming from higher oil production.

Monetary Policy Independence within an inflation-targeting framework has served Mexico well. This needs to continue, possibly with some reinforcement, for other policies to be effectively implemented, and not be derailed by instability and uncertainty in macroeconomic conditions, with their adverse effects on domestic savings and investment.

Strengthen governance and institutions including a focus on restoring a secure environment free of crime and drugs

Mexico faces twin governance challenges that are unforeseen by-products of the democratization and decentralization of the country. Democratization and decentralization have contributed to promote good governance at the Federal government level, but the resulting redistribution of political power has induced distortions to the incentives for good governance of some agents. First, the "fiscal federalism challenge" is a prime concern; sub-national governments derive most of their revenues from mandated fiscal transfers from the federal government, and thus do not feel obligated to their contributing constituency. A greater reliance on locally-collected taxes would provide the incentive to govern well and provide higher quality services that guarantees the growth of tax bases in the long run. Second, the accountability of sub-national governments ought to become a central topic in the agenda of Mexican federalism, since it can foster good governance by creating enforcement mechanisms that dissuade inadequate behavior. Accordingly, corruption could be reduced significantly at the sub-national level, although it also needs to be eradicated at the national level. This can be addressed by the elimination of non-transparent rules, state and private rent-seeking activities, as well as through the power of other vested interests, like the unions associated with government activities. In addition, Mexico needs to reform its political system, with greater accountability and openness to all interested citizens.

Over the past four years, Mexico has experienced an unprecedented increase in crime. From the early 1990s through 2007, indicators of criminal activity moved steadily downwards, to very low levels by Latin American standards. That progress has been mostly undone since 2008. The rapid deterioration is not explained by flaws in the institutional framework, or socio-economic factors that existed previously. More likely, the crisis was detonated by a combination of an aggressive turn in Mexican organized crime policy, a particularly conflict-ridden environment in the criminal world, changes in international drug markets, and increased availability of firearms, particularly from the US. The ensuing increased violence reduced the likelihood of punishment for any single act, increasing the incentives for additional crimes, and overrunning the already limited capabilities of the authorities. To reverse the trend and improve the security environment, a three-pronged approach is proposed. First, a focused deterrence strategy, prioritizing certain crimes, and acting on a collective basis on groups responsible for these acts. Second, a broad-based institutional reform effort, aimed at reducing the vulnerability to future shocks and producing value for money in the security and criminal justice systems. Third, community action and preventive policing approaches, and a major improvement of technological and intelligence capabilities.

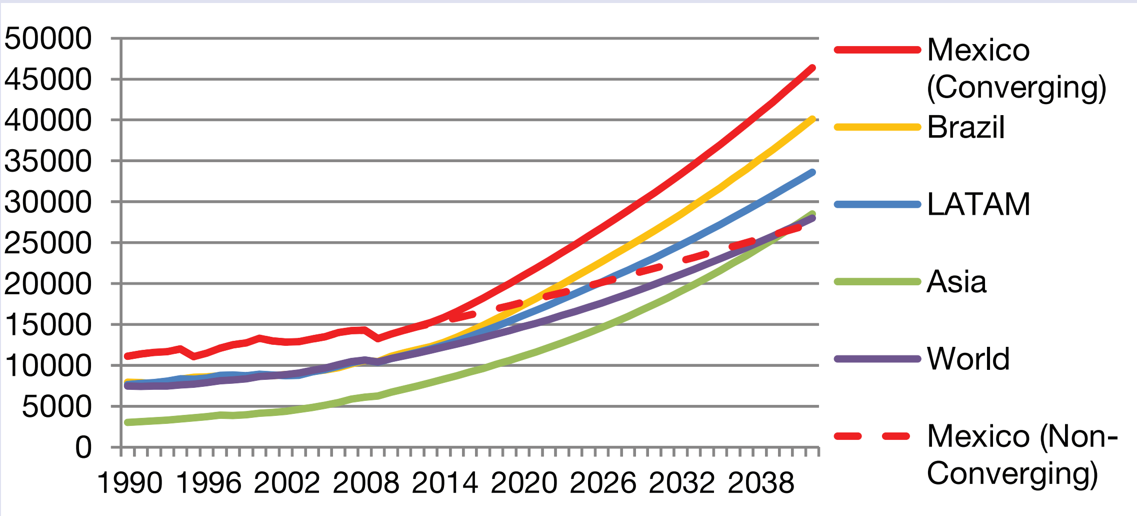
Consolidate Mexico's global position as a major emerging economy

While preserving its privileged relationship with the United States, Mexico needs to broaden the focus of its foreign relations. Greater attention to Central America is important to promote a more prosperous neighborhood and to curtail drug trafficking. Mexico's projection in Latin America and its closer links to the region are decisive in that the geographical diversification of its trade and financial relations would reduce its vulnerability to external shocks. Opening up to Europe and Asia would improve the availability of capital and know-how and enhance its capacity for long-term growth. Mexico needs to strengthen relations with the EU, and it has to look towards Asia as a partner, and not just as a competitor, with particular focus on China. Mexico should take greater advantage of its market potential, trade and investment, and it should continue its deep commitment to multilateralism and its role as a valuable member of the G-20, the OECD, the APEC and the OAS, and the UN.

The scenarios for sustained growth

On the basis of the policies discussed above, it is possible to envisage a scenario of prosperity and increased inclusion for Mexico over thirty years. The results could entail more than three times higher income per capita of what it is today, and Mexico could become a significant player in the world economy. But this is not a foregone conclusion. With

Figure 4 | **GDP per capita (constant US$, 2010, PPP)**



Source: Centennial Group projections

unchanged policies, per capita could double at best, but most likely will fall short of that if the underlying conditions deteriorate.

The growth scenarios are based on a well-established and tested methodology incorporated in earlier studies prepared by the Centennial Group.[5] The estimates developed can be summarized into two central scenarios: (a) Mexico breaks away from the middle income trap, and converges on the basis of good policies based on best practice, along with the rest of the world; and (b) Mexico does not break away from its current practices, and thus falls behind the world. The projection under the converging scenario is based on a strong new foundation for Mexico's policies, which is not in place at present.

In **Scenario 1**, Mexico converges, growing at an average rate of about 5% and reaching a GDP per capita just short of $50,000 by 2042 (in constant 2010 PPP dollars) compared to $13,800 at present. This is nearly twice the global average, and two thirds higher than Asia's. The country's GDP would be around $7.5 trillion, keeping Mexico's place as one of the largest emerging economies in the world.

In **Scenario 2**, Mexico remains mired in the Middle Income Trap, with GDP growth averaging 2.8% at best, and a GDP per capita of near $30,000 in 2042 (in constant 2010 PPP dollars) which is about the global average. Asia's GDP per capita surpasses that of Mexico. Brazil's GDP exceeds Mexico's GDP

5 In this model, GDP is projected for 185 countries as a function of labor force, capital stock, and total factor productivity. This model also incorporates an additional facet of the analysis of medium term growth, namely the sustainability of the external outcome and of fiscal policies. The methodology helps determine the consistency of policies, and the ability of the economy to absorb domestic and external resources over the medium- to long-term for the attainment of higher growth. These scenarios are constructed on the basis of the growth model developed by Centennial Group, and reflected in different studies including India 2039—An Affluent Society in One Generation; Latin America 2040—Breaking Away from Complacency; An Agenda for Resurgence; and Asia 2050: Realizing the Asian Century. The fiscal and external aspects are based on a modified version of the Debt Sustainability Analysis (DSA) originally developed by the WB/IMF.

considerably (180% higher compared to 60% in the previous scenario).

Concluding remarks

Mexico is at the crossroads in defining its future path of development. A vibrant and increasingly modern social structure is a positive factor, together with a fruitful association in NAFTA, a growing middle class and reduced poverty, and strong democratic governance. All of these factors provide the basis for a good future for the largest Spanish speaking country in the world, and the fourth largest economy of the Americas and second in Latin America.

At the same time, poor education and a dismal record in terms of factor productivity; the persistence of privileges, in the private, public or the labor union areas; informality and market deficiencies; and an increasing sense of lawlessness, caused by personal insecurity and gang violence; seriously cloud that picture. Inequality is high and poverty not yet eliminated, and a discouraged population sees that their hopes are shattered, as the population ages. Questions about the sustainability of the country's standard of living are becoming more urgent, at a time of declining oil wealth.

The action plan outlined here should be at the center of attention of those seeking to help Mexico break away from its seemingly hopeless, even if falsely comfortable, Middle Income Trap. It is not all-encompassing. Additional aspects of the strategy need to be considered, including those related to urbanization, the environment, emigration and internal migration. Together all these challenges will be embodied in the task that lies ahead for Mexico and its leadership—to formulate and to implement effectively a comprehensive plan of action with a perspective that goes beyond the usual six years of the political cycle. Of course, political economy considerations will shape the sequence of implementation.

A number of the issues to be addressed have long gestation periods and will cut across generations. However, an urgent start is called for. The later it starts and the less ambitious the reform agenda, the more Mexico is likely to remain mired in the Middle Income Trap, fall further behind other emerging economies, lose relevance in the global arena and, most importantly, deprive large segments of its population of an opportunity for greater prosperity. The potential payoff is huge—a GDP per capita of $50,000 by 2042 vs. at best $30,000 if it remains in the Middle Income Trap. Blame and escapism will not help; only action and cooperation will do the job.

The Emerging Markets Forum was created by the Centennial Group as a not-for-profit initiative to bring together high-level government and corporate leaders from around the world to engage in dialogue on the key economic, financial and social issues facing emerging market countries (EMCs).

The Forum is focused on some 70 emerging market economies in East and South Asia, Eurasia, Latin America and Africa that share prospects of superior economic performance, already have or seek to create a conducive business environment and are of near-term interest to private investors, both domestic and international. We expect our current list of EMCs to evolve over time, as countries' policies and prospects change.

Further details on the Forum and its meetings may be seen on our website at http://www.emergingmarketsforum.org

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