Economic Analysis

Mexico needs a fiscal rule

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Carlos Serrano
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Last week, the federal government submitted the fiscal package for next year to Congress. When analyzing it, the central reflection is that the country needs a fiscal rule. The proposal includes a public deficit of 4.9% of GDP by 2024, which, if materialized, will be the highest since 1990.

Fiscal deficits should not be demonized. Sometimes, they constitute an appropriate public policy that helps to face adverse situations or finance long-term infrastructure projects. Surprisingly, one is proposed, and of this magnitude, when at the same time the government forecasts a - very realistic - GDP growth rate between 2.5% and 3.5%; that is, above the potential growth rate, which I estimate to be at around 2%. A procyclical fiscal policy will be implemented.

The best fiscal practices, supported by economic theory and evidence, indicate that it is appropriate to incur a deficit in adverse times: when there are weaknesses in aggregate demand or falls in the prices of raw materials that a country exports (in Mexico´s case, oil), to avoid excessive contractions in economic activity.

But these good practices imply that in good times, when the economy grows above potential or the prices of export products increase, surpluses must be sought. The objective is that deficits and surpluses cancel each other throughout the economic cycle so that debt remains stable as a percentage of GDP.

Proposing a deficit in 2024 is worrying not only because it will take place in a year in which economic growth will not be weak but also because the increase in the said deficit will not be allocated to more public investment: almost 70% of the expected increase in the fiscal deficit will be going to current spending, which is not a healthy practice as it does not contribute to increasing the potential of the economy.

Worse still, there will be a primary deficit, which implies that tax revenues will not be enough to cover expenses, even without considering interest payments, which is not sustainable. Finally, a deficit is proposed when interest rates are higher than the historical average, which may complicate debt sustainability in the medium term. Instead of contracting debt at high interest rates to finance current spending, it would have been better to take on debt in times of low rates to build infrastructure.

This is not a problem that occurs for the first time. Nor is it the first time we have seen significant increases in public spending in election years or significant increases in debt to finance current spending, even when growth is expected to exceed potential. Recall the significant debt increase in the previous administration's first three years, which was also not allocated for public investment.

This procyclical policy leaves the country in a vulnerable situation. As indicated in the fiscal package, the next government must implement fiscal consolidation to reduce the deficit in 2025. But if a recession in the United States translates into a downturn in Mexico? Or if there is a sharp drop in international oil prices? Then, the next administration, considering that emergency funds have been extinguished, will not have room for maneuver to deal with these situations. The deficit would be more significant, the debt would grow, and the country would be vulnerable. We hope it doesn't happen, but we can't rule it out.

For all of the above, it is necessary to have clear rules that allow the implementation of countercyclical fiscal policies, avoid the interference of the political cycle in the fiscal position, and guarantee that public debt is used to finance infrastructure, not current spending. The Fiscal Responsibility Law has not proven to be sufficiently restrictive. It must be modified to have an effective fiscal rule. Chile could serve as an example.

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ENQUIRIES TO:
BBVA Research: Paseo de la Reforma 510, Colonia Juárez, C.P. 06600 Mexico City, Mexico.
Tel.: +52 55 5621 3434
www.bbvaresearch.com