Economic Watch

Mexico

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Economic Analysis

Mexico
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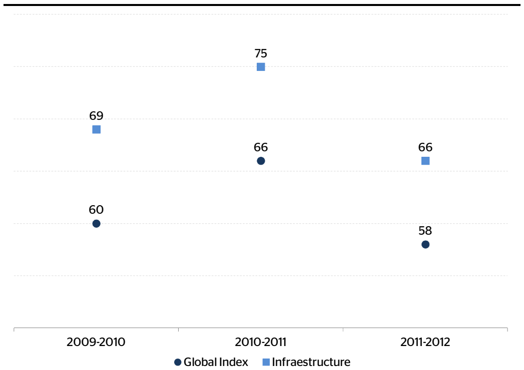
Public-Private Associations (APP) Act on correct path, showing results in the medium term

- **Mexico needs greater investment to boost its competitiveness**
- **The Public-Private Associations Act is a clear boost to investment**
- **Investment plans must take into account other productive sectors**

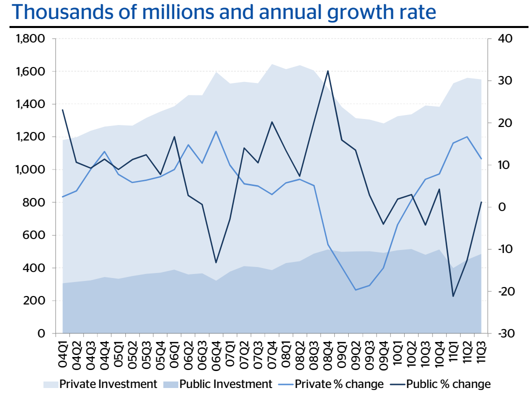
Investment is one of the most influential elements in the growth and development of economies, and therefore its promotion is a necessary task. According to the last competitiveness report of the *World Economic Forum*, Mexico has advanced 8 positions from 66 to 58; however, it remains far behind the most competitive economies. In particular, infrastructure has also improved by moving from 75th to 66th place in the ranking, but the country's position is under the general index for this indicator. Therefore infrastructure investment is an area of opportunity to improve competitiveness as well as foment growth and development of the country's economy.

Chart 1
Global Competitiveness Index 2008 to 2012
Index for Mexico



Source: Global Competitive Index, World Economic Forum

Chart 2
Gross Capital Creation
Thousands of millions and annual growth rate



Source: BBVA Research with INEGI data

Gross capital creation grew in 2010 at a rate of 2.3% on average, while until the third quarter of 2011 it has grown 8.7% on average. In both cases the private sector contributes over 60% of the investment and presents sustained growth over the last two years. Also, public sector investment seems to increasingly obey counter-cyclical rules, given that the greatest part of the growth is observed at the end of 2008 and the beginning of 2009.

The new Public-Private Associations Act

In December 2011 the Public-Private Associations Act was approved, aiming to boost investment. Although the legislation was published on the 12th of January this year, the regulation necessary for its application has yet to be published. We describe some of its articles hereinafter.

In article 2, it is observed that the purpose of the legislation is to regulate the contractual relationship between the public and private sector at the federal level for providing services to the public sector itself or to end users. However, the scope of this legislation goes beyond physical investment for the provision of services. In article 3, it also establishes that productive investment, applied investigation, and technological innovation projects are also considered, which would foment not only material investment but also investigation and development as well as human capital.

In spite of the fact that the projects carried out under this Act are not subject to the Public Sector Acquisitions, Leases, and Services Act or the Public Works and Related Services Act as established in article 7, a compromise is seen between transparency and accountability. The SFP will need to include in the Compranet government public information electronic system the information relative to the public-private association projects as per Article 11 of the legislation. Also, article 14 makes it mandatory for SHCP to publically coordinate and publish a report of information on public-private association projects, information to be considered public as per the Transparency Act. The SHCP itself is obliged to quarterly report to Congress on the amounts destined to the preparation of projects, as well as the adequacy of this scheme with respect to others in the Chamber of Deputies. The national expenditure budget must include the amounts spent and to be spent, the advance and committed payments of the projects as can be seen in article 14 and 24 of the Act.

This Act devotes its third chapter to non-requested proposals. In particular article 26 mentions that any party interested in carrying out a public-private association project may present its proposal. The aforementioned implies the elimination of a possible obstacle to the preparation of projects due to the lack of human and technical resources within areas of the Federal Government. On the other hand, the evaluation of these proposals is necessary to avoid biases resulting from the motivation of the private actors presenting proposals.

One of the advances of the Act is the flexibility afforded to these associations. During the original implementation term of the project, it will be possible to undertake modifications to improve the characteristics of the infrastructure, increase services, tend to environmental aspects, adjust the reach of the initiative, or reestablish its financial equilibrium. When the execution cost increases or benefits are reduced as a result of an act of authority subsequent to the presentation of the economic parameters which was not foreseeable and represents a change to the measures applicable to the development of the project, the contract will be revised to reestablish the financial equilibrium. The aforementioned is according to articles 117 and 119 of the Act. In addition, article 89 establishes that rights derived from authorizations for the provision of services may be transferred, given in guarantee, or used in any manner, which creates the possibility of a secondary market while increasing the possible funding sources.

Unlike the initiative, the Act establishes, in Article 98, that the terms of contracts shall not exceed 40 years including extensions. Article 123 stipulates that, upon termination of the contract, public buildings, goods, and rights that are part of the infrastructure or indispensable for the provision of the service will pass to the control of the contracting area.

Another favorable effect of the Act, in addition to the benefit of investment promotion, is that in increases the probability of moving forward on infrastructure works that have been on hold due to insufficient public funds. In turn this diminishes budgetary pressures on the Federal Government without the disadvantage of discouraging investment.

Joint investment opportunities

The act specifies that the SHCP must publish and justify each one of the public-private association projects. Still, this information has yet to be published (Tax Secretary José Antonio Meade specified that the project portfolio has not yet been identified). On the other hand, the application of this legislation is only for new infrastructure projects. However, the 2007-2012 National Infrastructure Plan (hereinafter PNI) is the best current reference of the investment projects contemplated to date.

The PNI stipulates, as its basic scenario, that public and private infrastructure investment will be between 3.0% and 4.5% of GDP, which could generate 720,000 jobs. The PNI considers the communications, transport, water, and energy sectors as priorities and projects to be undertaken under the 2007-2012 National Development Plan (hereinafter PND) are identified in a precise manner.

Table 1
Infrastructure Investment 2007-2012
in billions of pesos 2007

Sector	Total	Public	Private
Roads	287	159	128
Railways	49	27	22
Sea Ports	71	16	55
Airpots	59	32	27
Telecomm	283	19	264
Water & Sanitation	154	108	46
Irrigation & Flood control	48	36	12
Electricity	380	380	
Hydrocarbons	822	822	
Refining, Gas & Petrochemical	379	379	
Total	2,532	1,978	554

Source: National Infrastructure Program 2007-2012

Chart 3
Progress in PNI Investment 2007-2012
Amounts planned and paid for, billions pesos 2007

	Projected PNI* (2007-2012)			Registrado (2007-2011)			Progress (%)		
	Total	Public	Private	Total	Public	Private	Total	Public	Private
Roads	287	159	128	247	217	30	86.1	136.4	23.5
Railways	49	27	22	37	17	20	75.6	61.8	92.6
Ports	71	16	55	36	20	16	50.5	125.1	28.7
Airports	59	32	27	19	9	10	31.5	28.1	35.6
Telecomms	283	19	264	227	8	219	80.1	41.8	82.9
Water**	202	144	58	159	159	----	78.5	110.1	----
Electricity	380	380	----	199	199	----	52.4	52.4	----
Oil, gas & refinery	1,201	1,201	----	1,095	1,095	----	91.2	91.2	----
Total	**2,532**	**1,978**	**554**	**2,017**	**1,723**	**295**	**79.7**	**87.1**	**53.2**

Source: Office of the President of the Republic

According to the PNI major private investment opportunities are found in the telecommunications and roads sectors, and the trend continues to date according to the progress up to last year. Still, there are other areas of opportunity such as potable water and sewer systems, sea ports and airports; these three sectors still require over 140 billion pesos in investment, according to the Fourth PND Report. In particular, projects such as the Riviera Maya Airport or Punta Colonet are the most attractive.

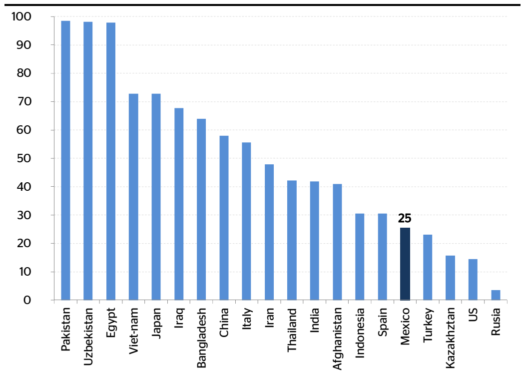
Table 2
Infrastructure Investment 2007-2012
in billions of 2007 pesos

Strategic Projects					
	Project	Amount		Project	Amount
Modernization of the highway network			Multimodal transport		
1	Durango-Mazatlan	10.8	1	Punta Colonet	20.9
2	Nuevo Necaxa-Tihuatlan	8.0	2	Manzanillo-Altamira	
3	Oaxaca-Salina Cruz	4.0	3	Lazaro Cardenas-Veracruz	
4	Guadalajara-Colima	1.5	4	Salina Cruz-Coatzacoalcos	
5	Tepic-Villa Union	3.0	Commuter trail in Valle de Mexico		28.0
6	Morelia-Salamanca	1.8	Sea ports infraestructure		
7	Arriaga-Ocozocautla	2.2	1	Manzanillo	7.3
8	Coatzacoalcos-Salina Cruz	2.4	2	Lazaro Cardenas	1.7
9	Veracruz-Tampico	6.8	3	Veracruz	3.7
10	Arco Norte	5.9	4	Altamira	5.1
			Airport infraestructure		
			1	New airport Riviera Maya	1.9
			2	Toluca airport extension	2.5

Source: National Infrastructure Program 2007-2012

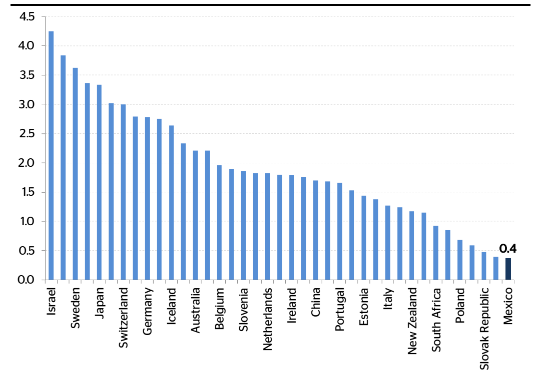
On the other hand, even though the PNI objectives are being fulfilled and the new act boosts investment through public-private associations, Mexico needs to continue to increase investment beyond the projects identified in the PNI itself. The greater reach of investment must not only be in terms of its total amount, but also benefit under-developed sectors and including those that have not yet been considered as potential beneficiaries of this type of instrument. For instance, in terms of irrigation infrastructure, Mexico falls far short in the coverage of its arable land compared to other developing economies. With regard to social infrastructure, or that which is not immediately related to productive activity, an important potential is seen. For instance, some projects for the construction of prisons are in the planning stages represent an investment of seven billion pesos.[1] To put this figure in context, it represents the public investment that has been planned annually in railways and agricultural infrastructure. Other projects that are also in waiting are linked to the construction of hospitals and schools.

Chart 4
Irrigation infrastructure
% of arable land 2010



Source: Fifth Government Report. Office of the Presidency

Table 5
R&D Spending
% of GDP 2010



Source: OECD Factbook

Conclusion: progress in the right direction, with apparent results in the medium term

The approval of the Public-Private Associations Act must be considered a step forward as it constitutes an incentive to investment by providing greater certainty for private investment and reduces reliance on public budgets. However, the benefits will not be immediate, due to the fact that both the regulation for the application of the Act and the specification of infrastructure investment projects have yet to be published. Moreover, projects to be promoted under this legislation, when also including federal government funds, will have to be accounted for in the Federal Government's Expense Budget. The political calendar will make it difficult to propose an ambitious list of infrastructure projects for 2013, although there should be beneficiaries of the new legislation as soon as during the first year of the next administration.

[1] Source: Infra Americas