

Discussion of “A Tale of Two Mexicos: Growth and Prosperity in a Two Speed Economy”

Angel Ubide*

D.E. Shaw and Peterson Institute for
International Economics

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* Views expressed here are my own and do not represent those of the institutions I am affiliated with

Mexico is no BRIC

- “Mexico Moment”
- Solid macro framework
 - Low inflation, stable fiscal, balanced CA
 - Credible IT regime
 - Robust fiscal framework
 - Flexible exchange rate, fully convertible, no capital controls
 - Well capitalized, profitable banks
 - Competitive exports, highly integrated into US

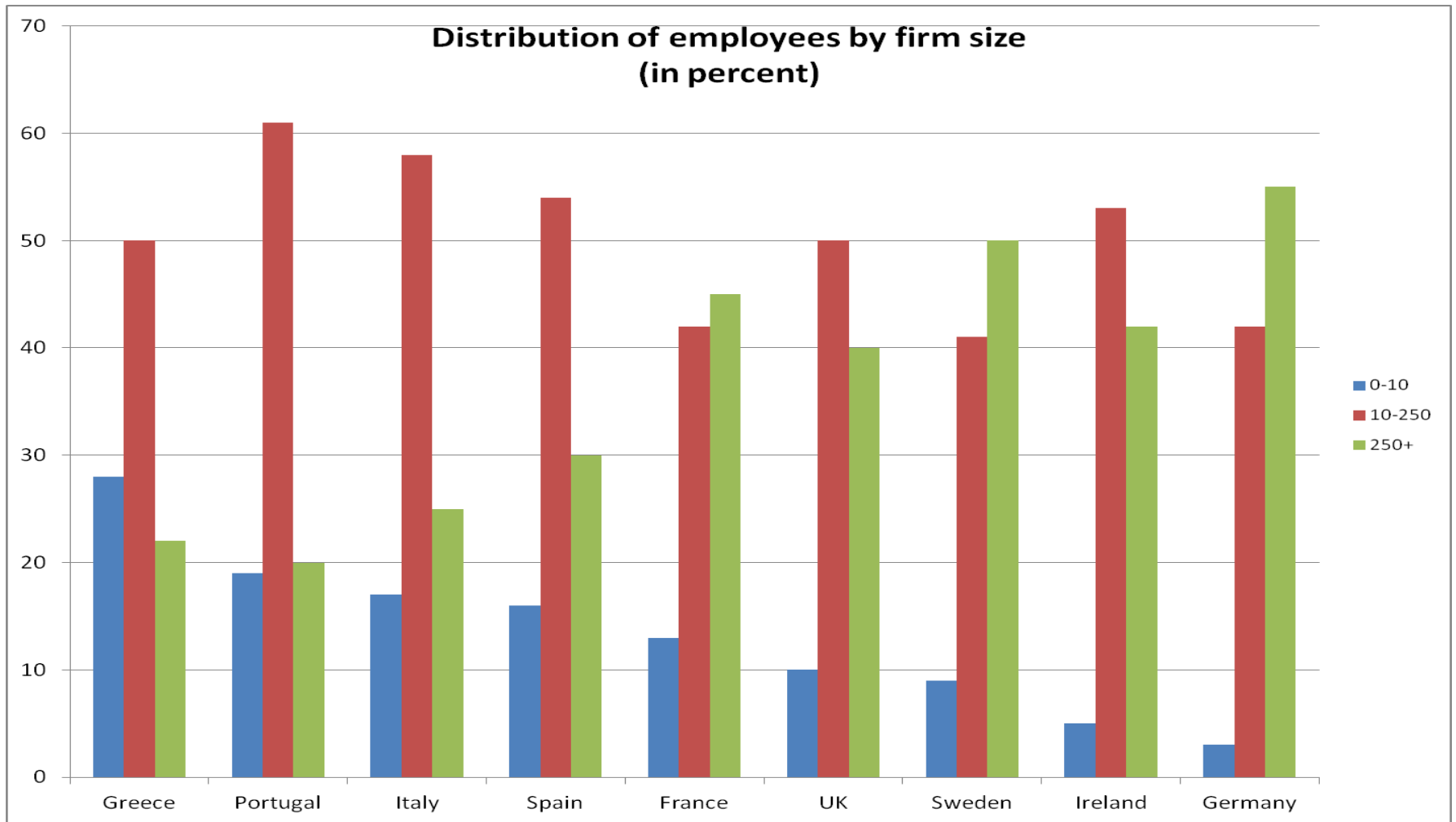
But weakness inside – Mck report

- A very MECE report
- (Dual economy)² – large vs small firms, formal vs informal sectors
- Result -> very weak productivity growth
- Reasons
 - Labor market restrictions – tax incentives/costs
 - Financial market restrictions – market failure
 - Legal restrictions – enforcement
 - Infrastructure gap - investment/energy/teleco reform
- Not just in Mexico...

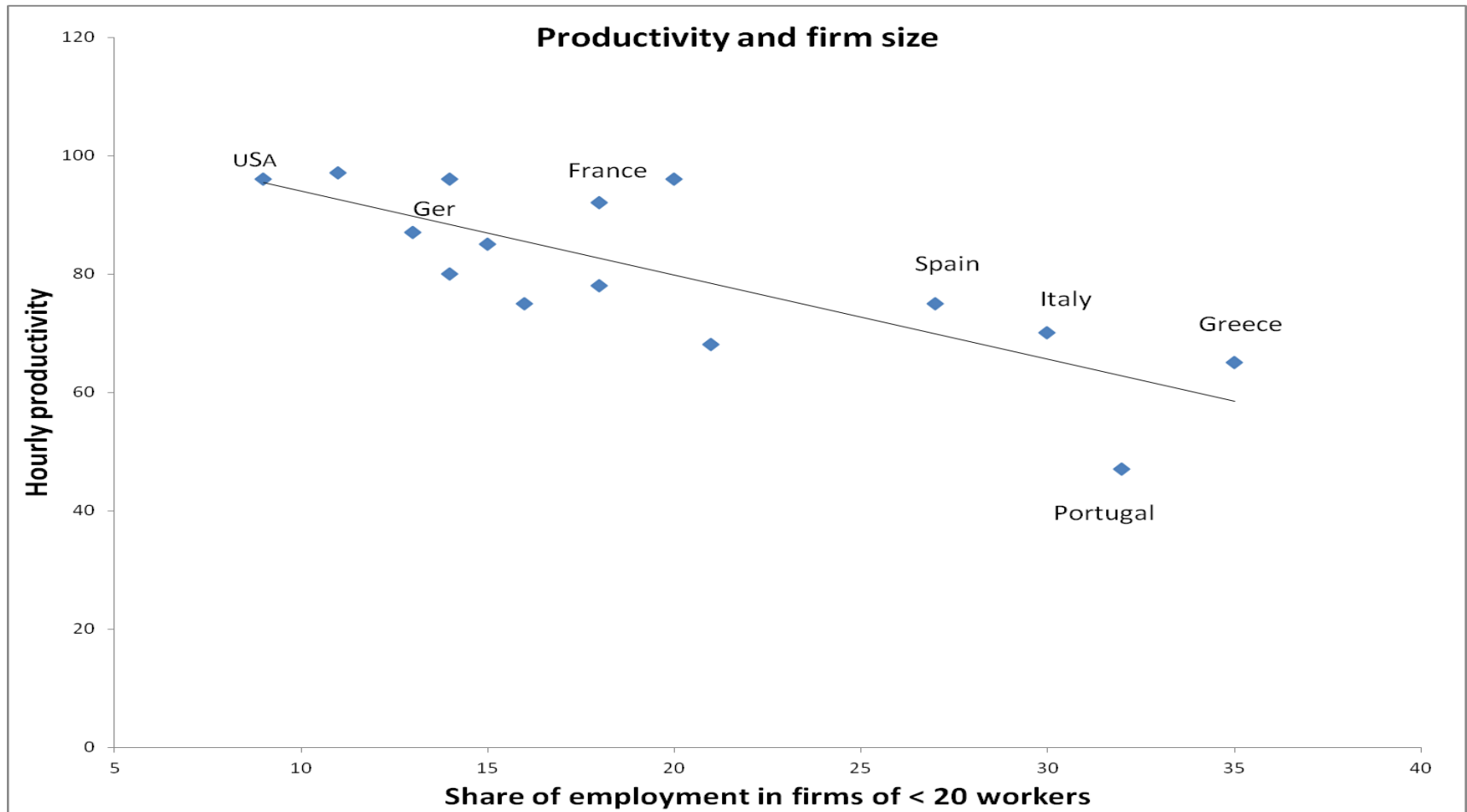
Not just in Mexico

- Differences in firm size account for half of Canada-US productivity differential (Leung, Meh, Terajima 2008)
- In France, firm size restrictions truncate distribution < 50 workers. Similar to 5-10 percent increase in wages. Garicano, Lelarge and Van Reenen (2012)
- Spanish and German firms are equally productive controlling for size – entire macro productivity gap due to size gap (La Caixa, 2012)
- In Spain, Large Taxpayers Unit led to abnormal bunching of firms below 6m EUR revenues. Firms below threshold less likely to grow or show profits next year (Almunia 2013)
- The incredibly shrinking Portuguese firm (Braguinsky, Bratsetter, Regateiro, 2011). Declining size of firms over last 20 years. Mostly due to labor market protection

Not just in Mexico



Not just in Mexico



Implications of (dual economy)²

- Too many small business owners who could be working for larger, more productive firms.
- Barriers to firm size and job creation relationship weakens if you control for firm age -> key is lower barriers to firm growth
- Thus lower barriers to churn. Up or out is key.
- Why are banks so risk averse? Good credit bureau
- Time to move from wage into firm size competitiveness?

Final points

- As capital inflows appear, don't manage the exchange rate.
- A strong exchange rate will force the churn
- We've seen negative impact of capital controls
- Political economy of reforms – need growth today to sustain effort for higher potential growth tomorrow. Opposite to conventional wisdom. Pay to reform (Wyplosz and Delpla)

Thank you