Mexico's Trust Buster

The decade of the BRIC countries is over. Let's not be fooled by summits or proposals to create a new world financial order. Today, Brazil is struggling with government overreach and a slowdown in demand for commodities. Russia is still the same kleptocracy. China is dealing with the mother-of-all credit binge hangovers. India too is slowing down, mired in corruption.

The action today is elsewhere. The growth engines in the emerging markets are now Turkey, Indonesia, Malaysia, Colombia, Peru and Mexico. These are countries opting for structural reforms. Their policy priorities are security, fighting corruption and deregulation. In a nutshell: free markets and the rule of law. No money printing, no ballooning deficits, no out of control debt, no gimmicks to avoid hardship at all cost. How refreshing.

The New Latin America.

The transformations are already visible, sometimes in a spectacular way. Medellin, for example, is now a prospering, even trendy place. It was even voted most "Innovative City of the Year" by the readers of the Walls Street Journal. That's right, Medellin of Escobar fame is now up there with Brooklyn.

In Latin America, a sad chapter was seemingly closed for good in the early 1990s. Swept by globalization, one country after another turned its back on military dictatorship. Since then, two distinct groups of countries have emerged. The first group embraced populism, mostly defined by a rejection of capitalism, a love of fancy names and a propensity to deify their leaders. Peronists, Sandinistas or Bolivarians are all variations on an old romantic dream of social revolution and wealth redistribution. Like their predecessors, the Castro dinosaurs, unfortunately, they cannot point to much economic success.

Then, there is the other group of Latin American countries, the one that is embracing modernity, democracy and free markets. These countries have in common a growing middle class as well as impressive GDP expansion.

Chile paved the way for the second group. Even before rejecting its dictatorship, Chile embraced free markets and a strong middle class. It has since been a beacon of democracy and free market orthodoxy in the Latin world. Other countries including Colombia, Peru and Mexico are following in their foot steps. In Colombia, President Uribe is rightly credited with ending civil war and turning around the economy. His successor is building on that success. Peru is the fastest growing economy of the region. However, the next big story could very well be Mexico. Already, it is replacing Brazil as investors' new darling.

Mexico

The evolution of Mexico has been gradual. It did away with dictatorship and then with one-party rule. It voted for NAFTA and opened its markets. The previous President fought the drug cartels head-on, with mixed results. Now, with the election of President Enrique Pena Nieto, Mexico is embarking on an acceleration of reforms that should unleash market forces like never before. Arguably the most important measure has already passed the lower house. It creates a new regulatory body that will have the power to enforce anti-trust laws.

For years, the Mexican judicial system lacked the independence and authority to break down monopolies. This is about to change. As a result, numerous sectors that have been choked by overwhelmingly dominant companies will be revitalized. Prices will come down thanks to renewed competition in industries as varied as telecoms, soft drinks, media, retail, cement or beer. It is not difficult to imagine what this will do to domestic consumption.

But Mr. Pena Nieto's ambition goes beyond his desire to be Mexico's Trust Buster. His ambitions go beyond emulating Theodore Roosevelt. He is also tackling outdated labor laws dating back to the 1930s that include more than 1,000 articles and have not been significantly modified in more than 40 years. Even if the law which went into effect a week ago does not seem too ambitious at first glance, it is an encouraging start. It will give employers a bit more flexibility, like the right to offer part-time jobs, hourly wages and the freedom to outsource when see fit. Such a law is of course welcome to employers, but it is also designed to take a number of jobs out of the informal economy. This, in turn, will help government revenues.

Together with outright corruption, the size of the informal economy is an ongoing problem in most emerging economies. Mexico is no exception. In fact, the International Labor Organization estimates 34.1% of Mexican workers labor in the informal sector - a high number by any standards. That's why the government hopes to bring more workers out of the shadows by relaxing temporary jobs regulations. More labor flexibility would help, but is politically difficult. Maybe fighting corruption in entrenched labor unions is a step in that direction. That would explain the arrest of Elba Esther Godillo for embezzlement on February 26. If anything, replacing him after 25 years of flamboyant leadership of the Mexican Teachers Union will allow for new blood and new thinking.

What is most remarkable is the astonishing consensus among political parties in support of these reforms. The anti-trust laws were passed with 414 yeas and only 50 nays. Even the new labor laws were passed with support from the main opposition party, the PAN. And more is in the making. Mexico is willing to address another taboo: the declining national income from oil production due to an inefficient nationalized industry. Measures to open up the oil industry to private and even foreign investments are now envisioned.

If these reforms come to fruition, economic activity will greatly benefit. The new President has a long "to-do" list with reducing violence at the top. Attracting more foreign investments would be easier if one no longer read about severed heads displayed along highways.

Already GDP per capita is a respectable $14,610*, although one wonders how much of that is due to Carlos Slim alone! The economy is growing at 4%*, unemployment is down to 5.3%* and inflation is under control at 3.4%*. In contrast to major economies stuck with huge debt burdens and more top-down so-called solutions, Mexico resisted moving towards more deregulation and resisted inflating public spending at the height of the financial crisis. Government expenditures as a percentage of GDP peaked in 2009 at a very reasonable 28.3% and were down to 24.5% in 2012 according to the IMF.

All this is welcome news for multinational companies growing more and more disenchanted with China. Producing south of the border of the largest economy in the world becomes increasingly appealing as China suffers from wage inflation.

According to Andres Rozental from the Brookings Institute, studies show that the all-in cost for an average factory worker in a Chinese industrial zone is more or less equal to a Mexican working in a maquiladora near the US border.

Furthermore, China's rather unique concept of the rule-of-law and increasing bullying of companies the government disapproves of makes Mexico look like an employer's paradise.

If the US economy manages to muddle through, Mexico should be a good place to invest. However stock selection matters. Deregulation will hurt the likes of (AMX), as the recent stock price correction indicates. Others, like Grupo Televisa (TV) could be net winners. Even as Televisa will have to give up market share (which stands at 70% today) in broadcasting business, it will also be able to grow its market share in the telecom business at the expense of AMX. Overall, the overwhelming winner will be the consumers. And there in lies the other opportunity for Televisa. Its media business may be forced to keep a smaller share of pie, but the pie could grow substantially. A more competitive and growing economy will multiply and inflate advertising budgets. A JP Morgan report puts Mexico's total ad revenues at 0.48% of GDP. In the US, this ratio is 1.02%, in line with most developed countries. But what if that ratio in Mexico climbs to Brazil's 1.14% or even Panama's 1.61%?

Global investors struggling with depressed European economies, slowing emerging markets and overactive central banks will appreciate the soundness of the Mexican reform story. It will not hurt them to also do some research at the Riviera Maya.