



PROPOSED ECONOMIC PROGRAM FOR 2010

- **THE FEDERATION'S REVENUE LAW INITIATIVE, THE EXPENDITURES BUDGET PROJECT FOR 2010 AND THE GENERAL ECONOMIC POLICY GUIDELINES WERE SENT TODAY TO CONGRESS.**
- **DURING 2009 THE INTERNATIONAL ECONOMIC AND FINANCIAL OUTLOOK CONTINUED TO BE ADVERSE AS A RESULT OF THE RECESSION THAT BEGAN IN 2008 AND INTENSIFIED IN THE FOURTH QUARTER OF THAT YEAR. ECONOMIC AND FINANCIAL CONDITIONS ARE EXPECTED TO BE MORE FAVORABLE THAN THOSE REGISTERED IN 2009, BUT THEY WILL BE LESS FAVORABLE THAN THOSE OBSERVED BEFORE THE INTERNATIONAL FINANCIAL CRISIS.**
- **IT IS EXPECTED THAT THE RECOVERY OF THE MEXICAN ECONOMY WILL START IN THE SECOND HALF OF 2009, AND WILL CONTINUE IN 2010. NEVERTHELESS, IT IS EXPECTED THAT DURING 2009 GDP WILL DECREASE BY 6.8 PERCENT DUE TO THE REDUCTION IN ECONOMIC ACTIVITY EXPERIENCED AT THE END OF 2008 AND EARLY 2009. FOR 2010 THE MEXICAN ECONOMY IS EXPECTED TO GROW 3.0 PERCENT, WHICH MEANS THAT THE LEVEL OF ECONOMIC ACTIVITY WILL BE BELOW ITS LONG TERM POTENTIAL.**
- **IT IS EXPECTED THAT THE AVERAGE REFERENCE PRICE FOR THE MEXICAN OIL MIX WILL INCREASE FROM A LEVEL OF 51 DOLLARS PER BARREL IN 2009 TO 53.9 DOLLARS PER BARREL IN 2010, AMOUNT STILL SUBSTANTIALLY LOWER THAN THE ONE USED FOR THE 2009 BUDGET (70 DPB). AT THE SAME TIME, A DECREASE IN THE OIL PRODUCTION PLATFORM FROM 2,622 THOUSAND BARRELS PER DAY IN 2009 TO 2,500 THOUSAND BARRELS PER DAY IN 2010 IS ANTICIPATED.**
- **THIS IMPLIES THAT EVEN THOUGH THE EXPECTED OIL AND NON-OIL REVENUES FOR 2010 WILL BE HIGHER THAN THOSE OBSERVED IN 2009, THEY WILL STILL BE BELOW THOSE USED FOR THE 2009 BUDGET. THIS IS DUE TO TWO FACTORS: LOWER TRANSITORY NON-OIL REVENUES AS ECONOMIC ACTIVITY WILL UNDER ITS POTENTIAL LEVEL, AND LOWER OIL REVENUES AS A RESULT OF A LOWER OIL PRICE AND THE CONTINUING DOWNWARD TREND IN THE OIL PRODUCTION PLATFORM.**
- **THEREFORE, IN THE ABSENCE OF FISCAL MEASURES MEXICO WOULD FALL INTO A SITUATION OF UNSUSTAINABLE PUBLIC FINANCES, OR IT WOULD BE NECESSARY TO CARRY OUT AN EXPENDITURE ADJUSTMENT OF SUCH A SIZE THAT IT WOULD NOT BE POSSIBLE TO FULLY COMPLY WITH NATIONAL**



PRIORITIES SUCH AS SOCIAL DEVELOPMENT, THE CRUSADE AGAINST ORGANIZED CRIME OR INFRASTRUCTURE INVESTMENT.

- **IN ADDITION, A GLOBAL ECONOMIC OUTLOOK WITH LIMITED GROWTH, MORE RESTRICTIVE CONDITIONS FOR INTERNATIONAL FINANCING THAN BEFORE THE CRISIS AND THE STRUCTURAL CONSTRAINTS AFFECTING THE COUNTRY ALL MEAN THAT, IN THE ABSENCE OF ADDITIONAL REFORMS, WE WILL CONTINUE TO EXPERIENCE INSUFFICIENT GROWTH TO ACHIEVE THE LEVEL OF DEVELOPMENT THAT THE COUNTRY NEEDS.**
- **IT IS THEREFORE IMPERATIVE TO ESTABLISH A REFORM AGENDA ALONG TWO LINES: A COMPREHENSIVE FISCAL REFORM AND A REFORM AGENDA TO PROMOTE COMPETITIVENESS, GROWTH, EMPLOYMENT AND POVERTY ALLEVIATION.**
- **THE FISCAL REFORM WILL LEAD TO AN ORDERLY ADJUSTMENT OF PUBLIC FINANCES THAT STRENGTHENS THEM IN THE SHORT AND MEDIUM TERM BY ESTABLISHING A STRONGER REVENUE BASE THAT SUBSTITUTES THE LOWER OIL REVENUES AND, AT THE SAME TIME, PROMOTE THE ECONOMIC RECOVERY AND GROWTH, JOB CREATION AND POVERTY ALLEVIATION.**
- **TO ACHIEVE THIS, ALL AVAILABLE INSTRUMENTS WILL BE USED: FIRST, IN ORDER TO FACE THE TRANSITORY DECLINE IN PUBLIC REVENUES, A TEMPORARY AND MODERATE FISCAL DEFICIT AND THE USE OF NON-RECURRENT REVENUES AND SAVINGS ARE PROPOSED; SECOND, THE PERMANENT REVENUE FALL DUE TO LOWER OIL PRODUCTION WILL BE DEALT WITH AN EFFORT OF ADJUSTMENT AND CONTENTION OF EXPENDITURES COMPLEMENTED WITH GREATER EFFICIENCY, TRANSPARENCY AND ACCOUNTABILITY, AND INCREASE THE COLLECTION OF NON-OIL TAX REVENUES.**
- **IT IS THE FIRST TIME, SINCE THE FEDERAL BUDGET AND FISCAL RESPONSIBILITY LAW IS IN PLACE, THAT THE EXCEPTION CLAUSE INCORPORATED IN THE LAW WILL BE USED, IN ORDER TO PROPOSE A BUDGETARY DEFICIT OF PS. 60 BILLION FOR 2010 (0.5 PERCENT OF GDP), DECREASING TO A PS. 40 BILLION DEFICIT IN 2011, AND EVENTUALLY RETURN THE A BALANCED BUDGET IN 2012, IN ALL CASES EXCLUDING PEMEX'S INVESTMENT. THE DEFICIT WILL BE COMPLEMENTED WITH NON-RECURRENT REVENUES TO DEAL WITH THE COMPLETE TRANSITORY DECREASE IN REVENUES, WHICH IS ESTIMATED TO BE PS. 155 BILLION IN 2010.**



- **THERE WILL BE AN EXPENDITURE ADJUSTMENT EFFORT WHICH INCLUDES A DECREASE IN PROGRAMMABLE EXPENDITURES FOR 2010 OF PS. 74.2 BILLION COMPARED TO THE AMOUNT APPROVED IN 2009. SIMULTANEOUSLY, ADDITIONAL MEASURES ARE REQUIRED TO ACCOMMODATE UNAVOIDABLE SPENDING PRESSURES AND TO ALLOW FOR A HIGHER ALLOCATION OF RESOURCES TO THE MAIN SOCIAL DEVELOPMENT PROGRAMS WHICH INVOLVES AN ADDITIONAL ADJUSTMENT BY PS. 143.8 BILLION. THE TOTAL EXPENDITURE EFFORT FOR 2010 WILL BE EQUIVALENT TO PS. 218 BILLION.**
- **MAJOR CHANGES TO THE FEDERAL PUBLIC ADMINISTRATION ARE PROPOSED, WHICH INCLUDES THE DISAPPEARANCE OF THREE MINISTRIES: THE MINISTRY OF PUBLIC ADMINISTRATION, THE MINISTRY OF AGRARIAN REFORM AND THE MINISTRY OF TOURISM. AT THE SAME TIME, THE MERGER OF THE NATIONAL LOTTERY WITH THE SPORTS LOTTERY IS PROPOSED. THESE STRUCTURAL CHANGE MEASURES WILL LEAD TO SAVINGS OF UP TO PS. 6.5 BILLION IN 2010 AND, AFTER THE COMPLETION OF THE RESTRUCTURING, SAVINGS COULD REACH PS. 8 BILLION IN 2011.**
- **THE PROPOSED EXPENDITURES BUDGET PROJECT FOR 2010 TAKES INTO ACCOUNT SAVINGS IN ADMINISTRATIVE, OPERATION AND PERSONAL SERVICES EXPENDITURES IN MINISTRIES AND ENTITIES BY PS. 80 BILLION.**
- **THE PUBLIC FINANCE STRATEGY TO FACE THE DECREASE OF PERMANENT FISCAL REVENUES CONSIDERS AMENDMENTS TO THE FISCAL FRAMEWORK AND A MORE EFFICIENT FISCALIZATION. WORTH NOTING ARE THE PROPOSED CHANGES TO EXCISE TAXES, THE INCOME TAX, THE UNIQUE RATE CORPORATE TAX AND THE TAX ON CASH DEPOSITS AS WELL AS A NEW CONTRIBUTION FOR POVERTY ALLEVIATION. THE PERMANENT REVENUES ASSOCIATED WITH THESE MEASURES ARE ESTIMATED TO BE PS. 176 BILLION, EQUIVALENT TO 80 PERCENT OF THE PERMANENT FALL IN REVENUES. WITHIN, THE INCREASE IN REVENUES ASSOCIATED WITH FISCALIZATION MEASURES ARE PS. 19.5 BILLION.**
- **IN LINE WITH THE PRIORITY OF THIS ADMINISTRATION OF REDUCING POVERTY AND PROMOTING EQUAL OPPORTUNITIES, THE ECONOMIC PACKAGE FOR 2010 WILL PRIVILEGE EXPENDITURES ON SOCIAL DEVELOPMENT. RESOURCES FOR THIS PURPOSE WILL HAVE A REAL INCREASE OF 2.5 PERCENT COMPARED TO THOSE APPROVED IN 2009. WITHIN, THE INCREASES IN SOCIAL SECURITY AND SOCIAL ASSISTANCE OF 15.0 AND 21.9 PERCENT, RESPECTIVELY, ARE WORTH HIGHLIGHTING.**



- **IT IS EXPECTED THAT BY 2010, FEDERALIZED EXPENDITURES WILL BE PS. 920.1 BILLION, AMOUNT HIGHER BY 0.3 PERCENT WITH RESPECT TO THE ONES APPROVED IN 2009 AND 17.5 PERCENT HIGHER THAN THOSE APPROVED IN 2006.**
- **THE PROPOSED REFORM AGENDA FOR COMPETITIVENESS, GROWTH, EMPLOYMENT AND POVERTY ALLEVIATION INCLUDES ACTIONS IN FOUR AREAS: IMPROVING THE OPERATION OF INPUT MARKETS TO REDUCE COSTS AND INCREASE COMPETITIVENESS; IMPROVING THE INSTITUTIONAL FRAMEWORK THAT DETERMINES THE RULES OF THE GAME IN WHICH ECONOMIC ACTIVITY TAKES PLACE; EXPAND THE MARKETS IN WHICH OUR GOODS AND SERVICES ARE TRADED; AND PROMOTE THOSE SECTORS THAT ARE LABOR INTENSIVE AND DUE TO THEIR REGIONAL CHARACTERISTICS, MAY HAVE A GREATER IMPACT ON EMPLOYMENT AND POVERTY ALLEVIATION.**
- **THE PROPOSED ECONOMIC PROGRAM WILL HAVE THE FOLLOWING RESULTS: THE BUDGET ALLOCATION TO STRATEGIC ACTIVITIES WILL BE PROTECTED, HEALTHY PUBLIC FINANCES WILL BE MAINTAINED, OIL REVENUES WILL BE SUBSTITUTED FOR PERMANENT RESOURCES, AND HIGHER ECONOMIC GROWTH, JOB CREATION AND POVERTY REDUCTION WILL BE ATTAINED.**
- **ACHIEVING THE MEASURES HERE DESCRIBED WILL REQUIRE A CONTINUOUS AND COORDINATED WORK WITH CONGRESS. WE HAVE A JOINT RESPONSIBILITY AND IT IS NECESSARY THAT WE RESPOND – IN A FRAMEWORK OF DIALOGUE AND RESPECT – TO ACHIEVE THE CONSENSUS THAT WILL ALLOW US TO IMPROVE THE WELFARE OF ALL MEXICANS.**



Today, September 8th 2009, the Federal Executive sent to Congress the Revenue Law Initiative and the Federation's Expenditure Budget Project for 2010. The initiative and the project were prepared according to the economic projections and strategies contained in the Economic Policy Guidelines for the next fiscal year.

The Mexican Economy in 2009

During the fourth quarter of 2008 and the first quarter of 2009, economic indicators showed a significant slowdown in production, aggregate demand and employment as a result of the deepening of the international economic and financial crisis.

In the second quarter of 2009, the annual contraction of GDP was higher than that recorded in the previous quarter, reflecting the slowdown in global economic activity, the change in seasonality due to the Easter holiday and the A/H1N1 influenza outbreak at the end of April and the beginning of May. However, in terms of seasonally adjusted sequential growth, in the absence of the epidemic, economic activity in the second quarter would have stabilized at about the same level as that in the first quarter of the year.

In response to the strength of internal elements of the Mexican economy, such as price and financial stability, and infrastructure investment associated with countercyclical spending, together with the recovery that has begun in the world economy, it is expected that the sequential growth of the Mexican economy will be positive during the second half of 2009.

Recent data are consistent with these projections, as the monthly growth rate of IGAE stabilized in June (-0.2), positive growth was observed in exports during June and July (1.3 and 1.6 percent) as well as in sales of the main departmental and supermarket stores in July (0.7 percent), and a monthly expansion in the number of formal jobs took place in June, July and August 2009 (64 thousand jobs).

It is expected that in 2009, Mexico's GDP will decline 6.8 percent, mainly due to the fall in economic activity experienced in late 2008 and the first semester of 2009. The forecast is similar to the expectations of private analysts surveyed in August by Banco de México (-7.2 percent). It is expected that by the end of this year, overall inflation will be close to 4.3 percent.

The sharp economic downturn in Mexico as well as the sharp decline in oil prices and the decrease in oil production will cause oil revenues and non-oil revenues in 2009 to experience their biggest decline in at least the past thirty years. As a result of the information observed in the January-July period and the described macroeconomic framework, budgetary revenues are expected to be lower by Ps. 477.5 billion compared with the level estimated in the Federation's Revenues Law of 2009.

The drop in oil revenues and non-oil tax revenues imply a net decrease of revenues, that is, after discounting by the lower non-programmable expenditures expected for the year, by Ps. 427.9 billion. In order to compensate this short-fall, the Federal Executive will use Ps. 342.9 billion coming from different sources of non-recurrent revenues: revenues from the oil hedge, revenues from the Oil Revenues Stabilization Fund (FEIEP), Banco de México's remnant of operation



corresponding to the fiscal exercise of 2008, and other royalties coming from non-recurrent operations.

Taking into account these compensatory measures, and to comply with the budget balanced rule established in the Federal Budget and Fiscal Law (LFPRH), the adjustment mechanism incorporated in the law was used to reduce public expenditures by Ps. 85.0 billion, which represents less than a fifth of the total decrease in revenues. This reduction is much more favorable than those implemented in past occasions in which lower revenues were registered, like in 1998 and 2001 when the ratio was totally the opposite: almost four fifths of the fall in revenues was reflected in lower expenditures by 78 percent of the adjustment will take place in current expenditures (Ps. 66.0 billion) and the remainder in expenditures associated to public works (Ps. 19.0 billion).

The use of non-recurrent revenues allowed us to maintain the countercyclical stimulus to the economy, so estimated expenditures at the end of this year will be higher than those approved for 2008 by close to Ps. 190.4 billion, and will be approximately equal to those observed that year.

By the end of 2009, the budget deficit is expected to be Ps. 251.2 billion, amount equivalent to Pemex's expected investment once the effect on Pemex's investment expenditures of the exchange rate depreciation is taken into account. Without considering Pemex's investment, the Public Sector would have a balanced budget.

The Public Sector Borrowing Requirements (PSBR), that is Public Sector's financing requirements needed to achieve its policy goals, are estimated at 3.3 percent of GDP by the end of 2009, which is 1.2 percentage points of GDP higher than the one at the end of 2008, and higher than that originally estimated for the year by 0.3 percent of GDP due mainly to a lower economic activity than that which was anticipated.

Economic Perspectives for 2010

The international environment is expected to be more favorable than the one observed during this year. This is due to the process of economic recovery in both industrialized and emerging countries, as well as the gradual reestablishment of better financing conditions in international markets. However, the expected conditions will not be as favorable as before the international financial crisis took place.

Consistent with the anticipated recovery as of the second semester of 2009, it is estimated that Mexico's real GDP will register an annual growth rate of 3.0 percent, forecast similar to the one by private sector analysts (2.9 percent according to the August Survey carried out by Banco de México). Nevertheless, the level of the economic activity will be lower than the one originally expected for 2009. The economic scenario anticipated for 2010 takes into account a forecast of inflation of close to 3.3 percent.

The reference price for the Mexican oil mix forecasted for 2010 is 53.9 dollars per barrel (dbp), 5.7 percent higher than that anticipated for 2009 (51.0 dbp) but 23 percent lower than that originally contemplated for 2009 (70 dbp). The oil production platform is expected to decrease by 4.7



percent between 2009 and 2010, from 2.6 million barrels per day (mbd) to 2.5 mbd, respectively. This implies that the decrease in the production platform between 2005 and 2010 is of 833 thousand barrels per day (25 percent), which results in a permanent drop in revenues of Ps. 619.6 billion when the fall in production is evaluated at the expected oil price and exchange rate for 2010.

The weak external environment, the level of economic activity below its medium term potential, and lower oil prices and production imply that public revenues will be significantly lower than those in the budget for this year. As a result, a public policy strategy along two dimensions is proposed:

- A comprehensive fiscal reform whose objective is to face the sharp fall in revenues of the Federal Government, seeking to maintain the medium term solvency of public finances, and at the same time, to stimulate the economic recovery and growth, job creation and poverty alleviation.
- An agenda of reforms to increase competitiveness, growth, employment, and poverty alleviation that contemplates actions to reduce costs and improve market access for firms, the strengthening of the institutional framework and complementary measures in particular sectors.

Public Finances Framework

For 2010, it is anticipated that both oil and tax revenues recover with respect to those observed this year, but they will continue to be lower than the revenues originally used in the 2009 budget. At the same time, there will not be the same amount of non-recurrent revenues as were observed this year. Estimated revenues for 2010 will be lower by almost Ps. 374 billion than those originally anticipated for 2009, which implies a gap equivalent to 3 percent of GDP. This gap includes a transitory drop in revenues by Ps. 155 billion (41.4 percent of the lower revenues), and a permanent decrease of Ps. 219 billion (58.6 percent).

To face this situation, the strategy of public finances to offset the reduction in fiscal revenues will use all available instruments:

- *Debt and non-recurrent revenues:* We will incur in a temporary and moderate fiscal deficit, which, together with non-recurrent revenues and savings will amount to Ps. 155 billion in 2010. This is equivalent to the decrease in revenues due to the economic cycle. These measures are only transitory as during the cyclical recovery, the improvement in revenues will allow us to come back to a balanced budget.
- *Rationalization and higher efficiency of expenditures:* Total expenditure adjustments will be Ps. 218.0, considering a lower expenditure ceiling than that for 2009 by Ps. 74.2 billion, together with Ps. 143.8 billion in additional measures required to allow us to increase social expenditures and cover funding pressures associated to pensions and to promote a better operation of the entities under direct budgetary control.
- *Permanent non-oil income:* Collection of permanent non-oil revenues will be increased through modifications to the tax framework and a more efficient tax administration. The measures are expected to lead to an increase in revenues by Ps. 176 billion and will allow us to cover close to



80.0 percent of the fall in oil revenues anticipated for 2010. The remainder will be compensated with expenditure adjustments, recognizing the permanent reduction of oil revenues.¹

Public Balance

For the first time since the Federal Budget and Fiscal Law (LFPRH) was in place, the exemption clause embodied in the law will be used in order to propose a temporary deficit linked to the fact that during the next two years production is anticipated to be below potential. The proposed budget deficit, without considering investment by Pemex, is of Ps. 60.0 billion during 2010, which will be reduced to a deficit of Ps. 40.0 billion in 2011, to finally have a balanced budget in 2012.

The estimated remnant of resources from the stabilization funds and other non-recurrent revenues and royalties, for a total of Ps. 95.0 billion in 2010, will be used to complement the deficit. Together with the financing coming from the deficit, these resources will allow us to face the total amount of the transitory short-fall in revenues estimated to be Ps. 155.0 billion.

Finally, with the aim of strengthening the fiscal responsibility framework, the proposal is complemented with the following measures:

- In case a deficit higher than Ps. 40.0 billion is approved for 2011 the amount exceeding Ps. 40.0 billion must be compensated with a lower deficit in 2010. This adjustment would take place only if the adjustment is not justified by a non-anticipated change in the economic environment.
- It is proposed that in 2010, in case windfall revenues are observed, different from those that would be assigned to the Federal Entities Stabilization Fund (FEIEF), they will be employed to improve the public balance. Once the budgetary equilibrium is reached, without considering Pemex's investment, they will be distributed according to the criteria established in the LFPRH.
- For 2010, the maximum reserve level of the stabilization funds would be eliminated, in order to accumulate a greater amount of resources in case windfall revenues are observed, in order to face shocks like the one currently experienced.

Fiscal Reform

The design of the tax package presented for 2010 is envisaged to establish a sound base of public revenues that allows us to reduce the dependence on oil revenues and compensate their reduction. Consistent with the idea of strengthening the overall tax system, the proposal contemplates modification in all taxes that become an integral part of the tax system (Income Tax, ISR, IETU, IDE and IEPS) and the creation of a new contribution, with the aim that the increase in permanent revenues generates the least possible distortions, that employment and investment are not affected,

¹ The difference between the gap of Ps. 374 billion and the sum of the proposed measures is due to higher financing costs, adefas and contributions to states by Ps. 30.9 billion.



nor is any particular sector. In doing so, proposals to widen the tax base in all contexts follow these principles:

1. To protect investment and job creation.
2. That the increase in tax revenues comes mainly from those groups with higher incomes.
3. To reduce the possibility of applying aggressive fiscal strategies and reducing tax evasion.
4. Measures associated to consumption are focused in goods with negative effects on individuals' health, to collect revenues associated with the use of a good that is national property, or designed to contribute to greater expenditures in order to reduce poverty and improve the health system.

Excise taxes

The measures are intended to limit consumption of goods with negative health effects, or capture part of the rent associated to a good that belongs to the nation.

- The tax rate on beer will be increased from 25 to 28% during 2010-2012, with a posterior decline to 27% in 2013, and 25% in 2014.
- A quota of Ps. 3 per liter for alcoholic beverages with more than 20° GL is proposed.
- The establishment of a quota of 80 cents per gram of tobacco, or per cigar, per soft or flip top box in 2010, until a quota of Ps. 2 per box is reached in 2013. In addition the obligation to print the security code in tobacco boxes in order to prevent smuggling would be established.
- With respect to games and lotteries, an increase in the tax rate from 20 to 30%.
- In the telecommunications sector, the establishment of a 4% tax rate to those services offered through a public network, excluding the public and rural phone network, as well as the linking service.

Contribution to Alleviate Poverty

In order to channel the efforts and resources of the Mexican State to stop the increase in poverty and mitigate the negative impact that the global food and economic crisis has had on the low income population, the Contribution to Alleviate Poverty is proposed. By these means, we would all participate in a proportional and fair manner to generate the required public revenues to comply with this responsibility of the Federal Government.

The rate of the Contribution would be 2% and would be applied in a general way, taxing the sales of all goods and services to insure the tax burden is not concentrated on a specific sectors but rather that it is distributed in the broadest possible way. In order not to affect exports, these would have a zero rate.

The Contribution has a cash base, and it applies to all stages of production in a non-cumulative way, allowing it to be credited.



It would not imply an additional administrative burden. Nevertheless, the SAT will issue dispositions such that the payments of this contribution take place in the same way as for other contributions.

The revenues generated by the Contribution will allow us to increase the budgets of most of the programs designed to fight poverty:

- The budget of the Program for Human Development “Oportunidades” and the Food Support Program will increase by in Ps. 31.5 billion to reach Ps. 81.1 billion in 2010. This will allow us to significantly increase the coverage of these programs to benefit, at least, 6.5 million families, equivalent to 32.5 million Mexicans.
- The educational component of the Program for Human Development “Oportunidades” will register a real increase of 20.3%. This means that Ps. 23.3 billion will be assigned to support children and teenagers that attend school.
- The contribution will enable the allocation of Ps. 4.5 billion to communitarian actions and compensatory programs for children and young people with no access to formal educational services through the National Council of Educational Promotion.
- The Popular Insurance will be able to maintain the affiliation of 10.4 million families in 2010, number with which 2009 is estimated to close. The budget of the Program will increase to Ps. 53.63 billion.
- The Program for Healthy Communities that promotes health in municipalities through a set of actions that increase the public’s health conscience, will show a real growth of 68.1 percent, totaling Ps. 115.3 million pesos.
- The Program Caravans for Health will have an increase of 18% that translates into Ps. 760.7 million.
- The Integrated System for Health Quality will show real growth of 55.7 percent, due to the fact that the resources allocates to this new strategy will be Ps. 188.8 million. This will help the timely supply of medicines and to improve the quality in the management of health services.
- The Temporary Employment Program will manage to generate 35.1 million temporary day-jobs during 2010, this means 14.5 million more than originally planned for 2009, and 4.8 million temporary more day-jobs than those expected for year-end. The proposed budget in 2010 for this program is of Ps. 3,080 million, which represents an increase of 27.8 percent in real terms.
- The Basic Infrastructure Program to Support Indigenous Peoples maintains its allocation in real terms, reaching Ps. 4.6 billion. With this program it will continue attending the basic infrastructure needs of the indigenous communities.



- The Indigenous School Shelters Program (PAEI) will be assigned Ps. 789.4 million in 2010, representing an increase of 16 percent in real terms respect to 2009.

Income taxes

During the last 8 years, the rate of the income tax was decreased by over 10 percentage points, to a level that is not sustainable under the current economic conditions. Thus, there will be a temporary increase in the rate that will still continue to be at a reduced level compared with the ones observed in other countries. In addition, the proposal seeks to eliminate aggressive tax planning practices and continue fighting informality.

- In terms of the income tax (ISR);
 - Regarding fiscal consolidation, differed Income Tax payments older that five years will be made mandatory for those groups which consolidate, through a payment schedule that implies that in each fiscal exercise the 60% of the tax deferred balance is applied in that exercise, and the remaining 40% divided in four 10% payments during the next four years.
 - Temporarily increase income tax rates for businesses and individuals, the highest placing the highest bracket at 30% in 2010-2012, at 29% during 2013 and at 28% in 2014.
 - Increase the rate of primary sector to 21%.
- For the tax on cash deposits:
 - Increase the rate from 2 to 3%.
 - Reduce the exempt limit from 25,000 to 15,000 monthly peso deposits.

PEMEX's Tax Regime

The Federal Government proposes to improve the tax regime applied to PEMEX. Specifically, it proposes to give the company more financial flexibility to explore new oilfields in deep waters and in the "Paleocanal de Chicontepepec" and so, in an environment of economic efficiency, the company will increase its income generation which will contribute to develop the oil national industry, strengthening public finances and promoting national development.

The new tax system is built on the architecture that has been created in recent years, so the elements incorporated in the proposal are:

- Right on the extraction of hydrocarbons. The current regime provides for an annual fee for the extraction of crude oil and natural gas fields in the "Paleocanal de Chicontepepec" and deepwater fields which is calculated by applying a variable percentage rate of up to 20 percent of the



annual value of crude oil and natural gas extracted in the year. The proposal contemplates the application of a fixed percentage rate of 15 percent applied to the same base.

- Excise duty on mineral oils. Initial low tax rates that are set to gradually increase with the level of accumulated production of each field, enabling the implementation of a robust tax system to changes in oil prices, production costs and the size of discovered oilfields.
- Additional Excise duty on mineral oils. In order to capture the oil revenues generated at higher prices when these are above 60 U.S. dollars per barrel (dbp), an excise would be applied on the following basis: a rate of 52 percent on the product of i) the number of barrels of oil equivalent extracted and ii) the difference between the observed price per barrel and 60 U.S. dollars.

Tax Administration

In terms of tax administration, actions will be taken along two lines:

1. Simplification measures: taxpayers will be allowed to use their bank accounts and digital invoices as tax receipts; to pay their taxes using credit cards and to process returns via Internet; and the interest tax calculation for individuals will be simplified, so that is effectively related with the real interest received by individuals.
2. Fighting tax evasion: the precautionary assurance process will be strengthened, particularly in cases where there is a high risk that resources disappear and the authority will be enabled to recover debts by collecting on accounts that the corresponding taxpayer has in the financial system.

The actions in matter of tax administration will increase efficiency and improve the results in the fight against tax evasion. Therefore, it is expected that the measures that are proposed will increase tax collection by Ps.19.5, 27.5 and 36.5 billion in 2010, 2011 and 2012. This is in addition to the increase by Ps. 26 billion associated with the approval of the previous tax reform.

It is estimated that the fiscal reform proposal that the Federal Executive submitted for the consideration of the Congress will generate during 2010 additional permanent tax revenues by about Ps. 175.7 billion (equivalent to 1.4 percent of GDP), of which 32.3% (approximately 56.7 billion pesos), correspond to the states and municipalities through shared revenues and contributions.

The proposed measures will increase the permanent sources of income significantly with respect to those anticipated for 2009. Together with the economic recovery, this will contribute to a gradual recovery in total public revenues, even though oil revenues will be permanently lower as a percentage of GDP than those originally anticipated for 2009. In the composition of public sector revenues, the proportion of non-oil revenues of total public revenues would change from 63.6 percent in what was approved in 2009 to 68.7 percent as proposed for 2010, and to 68.8 percent



of expected revenues for 2015 as a result of the gradual substitution of oil revenues with other sources of revenues that are permanent.

Budgetary Revenues with measures, 2009-2015 (% GDP)								
	2009		2010	2011	2012	2013	2014	2015
	Approved	Estimated						
Total	23.6	22.4	22.1	22.1	22.1	22.0	22.0	22.0
Oil related	8.6	6.6	6.9	7.1	7.0	6.8	7.0	6.9
Non-Oil related	15.0	15.8	15.2	15.0	15.1	15.2	15.0	15.2
Tax revenue	10.6	9.3	10.8	11.2	11.2	11.4	11.3	11.5
Non-Tax revenue	0.5	3.2	0.9	0.3	0.3	0.3	0.3	0.3
PEDBC	3.9	3.3	3.5	3.5	3.5	3.5	3.4	3.3

Public Expenditure Strategy

The proposed strategy seeks to reduce the level of programmable expenditures, without PEMEX's investment, in 2010 by Ps. 74.2 billion relative to the amount approved for 2009, and to maintain this level as a percentage of GDP in subsequent years. At the same time, it will be necessary to undertake additional expenditure adjustments to accommodate expenditure pressures associated with pensions and the expenses that are required by CFE and PEMEX for a proper operation, so that the total amount of adjustment in expenditures will be Ps. 218 billion.

The magnitude of the required expenditure adjustment, 1.7 percent of GDP, means that the Federal Government will make an extraordinary effort of austerity and rationalization in the public administration, ranking priorities based on essential expenses and eliminating all programs and items that do not contribute substantially to the main objectives of the Administration. For this, a reform will be sent to Congress that allows for a ranking, based on criteria of efficiency, transparency and austerity, Federal Government expenditures; that reduces its administrative cost, and inviting the Legislative and Judicial branches and various levels of Government, autonomous bodies and political parties to make an effort in the same direction.

In this respect, there are proposals of major transformations to the Federal Public Administration, which implies the disappearance of three Ministries: the Ministry of Public Function, the Ministry of the Agrarian Reform and the Ministry of Tourism. Functions that these dependencies have been recently performing will be absorbed within other government structures, generating as a result significant savings due to the elimination of duplicities, the synergies that will be obtained and the disappearance of administrative areas or with a low level of productivity. These structural measures will allow us to obtain savings in the order of Ps. 6.5 billion in 2010 and, once the restructuring concludes, savings of up to Ps. 8 billion in 2011.



The measures of expenditure contention and higher efficiency consider total savings in administrative and operative expenditures and in personnel expenditures of the Ministries and Entities by Ps. 80 billion. Among these, the following are worth mentioning:

1. Regularization of savings in personnel services due to vacancies in Ministries and Entities of the Federal Public Administration.
2. Lower administrative and operative expenditures. This includes expenses on materials and provisions, basic services, official services, consulting and evaluation, social communication, diffusion and information, donations, *per diem*, trips, telephony, subcontracts with third agents, technologies of information, among other current expenditures.
3. A five per cent reduction in the structure of higher public servants. Expenditures associated with the structures going from Under-Secretaries of State to General Adjunct Directors (or similar posts) will be reduced by at least five per cent in each of the administrative branches or state enterprises of the Federal Public Administration.
4. Likewise, there will be a reduction of five percent of the associated budget of administrative structures of the Ministries, organisms and state enterprises, including major administrative offices and similar areas. This is to avoid any kind of duplicity of functions and optimize efforts.
5. A 10 percent reduction of the expenditures associated to offices and representations of the Federal Government in foreign countries.
6. Reduction of 10 percent of the expenditures on the administrative structures of delegations, offices and representations of the Federal Government, organisms and state enterprises in the Federal Entities.

In addition, during 2010 for the ninth consecutive year a policy of null increase in the remunerations of medium and high posts of the Federal Government will be followed. If this policy is added to the 10 percent decrease in the salary of high ranking posts established in the decree of December 2006, the purchasing power of such public servants will have decreased by 39 percent from 2003 to 2010.

Besides the great effort of austerity, the expenditure policy for 2010 is guided by the following lines of action:

- I. Foster higher social development and protect lower income households.
- II. Reactivate the economy and retake the path of growth.
- III. Preserving security and continue the crusade against crime.
- IV. Continue with other high ranking issues of public expenditure policy

By 2010, the estimated amount of budget revenues and the deficit target proposed for 2010, imply that the total net expense paid will be Ps. 3,146.4 billion. Excluding PEMEX's investment and the increase in contributions to Federal Entities associated with the proposed tax measures, the total net expense paid would be Ps. 2,867.8 billion, lower by Ps. 58.5 billion compared to the amount approved in 2009.

Paid Total Net Expenditure, 2009-2010 Without Pemex's investment (Billion pesos of 2010)				
	2009 PEF	2010	Differences	
			Absolute	Relative
Total without PEMEX's investment	2,926.3	2,867.8	-58.5	-2.0
Programmable paid	2,166.3	2,093.3	-72.9	-3.4
Deferred payments	-27.3	-26.0	1.3	-4.6
Accrued ^{*/}	2,193.5	2,119.3	-74.2	-3.4
Non programmable	760.0	774.5	14.5	1.9
Financial Cost	303.9	300.9	-3.0	-1.0
Shared Revenues	450.9	453.6	2.7	0.6
Adefas	5.2	20.0	14.8	281.6

^{*/} It does not consider the increase in shareable revenues derived from the fiscal reform.

Accordingly, the payable programmable expenditures ceiling for 2010 is Ps. 2,397.9 billion. If these expenditure are adjustment by the increase in contributions to the States due to the reform and investment in PEMEX is excluded, the payable programmable expending ceiling would be Ps. 2,119.3 billion, Ps. 74.2 billion lower than the level approved for 2009 (3.4 percent real).

In terms of the economic classification of programmable expenditures, the expenditure projections are grouped according to their economic nature and object, that is, current spending and capital expending. For fiscal 2010, current expenditures will account for 77.6 percent of programmable expenditures, while the remaining 22.4 percent will be capital expenditures. In relation to what was approved in 2009, worth highlighting within current expenditures is the real increase in pensions as well as in subsidies by 16.1 and 4.1 percent, while operational expenditures decrease by 2.1 percent; regarding capital expenditures, physical investment is basically maintained at the same level in real terms.



Programmable Expenditure of the Public Sector, 2009-2010 (Billion pesos of 2010)				
	2009 PEF	2010	Differences	
			Absolute	Relative
Total	2,432.0	2,397.9	-34.1	-1.4
Current Expenditure	1,811.6	1,861.2	49.5	2.7
Personnel Services	822.3	829.1	6.8	0.8
Pensions	263.9	306.5	42.6	16.1
Subsidies	332.3	291.6	-40.8	-12.3
Operational	393.0	434.0	41.0	10.4
Investment Expenditures	620.3	536.7	-83.6	-13.5
Physical Investment	493.9	490.1	-3.8	-0.8
Others	126.4	46.6	-79.8	-63.1

In terms of their administrative classification, expenditure provisions are grouped according to expenditure executors, in terms of government branches and public entities. For 2010, the proposed expenditure for the Autonomous Branches is Ps. 60.5 billion, which implies a 4.9 percent real increase compared to the approved amount for 2009.

For 2010, the Expenditures Budget Project considers Ps. 767.7 billion for Administrative Branches, which will represent a 7.6 percent real decline compared to the approved amount for 2009. Within, the Ministries of Social Development and Foreign Relations will have a higher budget than that approved for 2009, by 17.9 and 8.7 percent, respectively.

Programmable expenditures for next year proposed for Public Entities under Direct Budgetary Control is Ps. 1,067.6 billion, which represents a 5.1 percent real increase compared to the approved amount for 2009, which highlights the need to fulfill the budgetary requirements of such entities so they can operate properly.



Programmable Expenditures of the Public Sector, 2009-2010 Administrative Classification (Billion pesos of 2010)				
	2009 PEF	2010	Differences	
			Absolute	Relative
Total	2,432.0	2,397.9	-34.1	-1.4
Autonomous Branches	57.7	60.5	2.8	4.9
INEGI	8.0	8.8	0.7	9.3
Administrative Branches	830.7	767.7	-63.0	-7.6
Presidency	1.9	1.7	-0.2	-8.3
Government	10.1	8.6	-1.4	-14.1
External Affairs	5.6	6.1	0.5	8.7
Finance and Public Credit	38.4	34.1	-4.4	-11.3
National Defense	45.7	42.5	-3.2	-7.0
Sagarpa	74.1	60.8	-13.3	-18.0
Transport and Communications	76.0	61.6	-14.4	-18.9
Economy	14.8	13.2	-1.6	-10.7
Public Education	210.6	196.4	-14.2	-6.7
Health	89.1	89.4	0.2	0.3
Marine	16.8	15.9	-0.9	-5.6
Employment and Social Provision	4.3	3.8	-0.5	-12.1
Agrarian Reform	6.1	4.4	-1.7	-27.9
Semarnat	47.2	40.5	-6.7	-14.3
PGR	12.9	12.1	-0.8	-6.3
Energy	45.9	38.3	-7.7	-16.7
Social Development	71.4	84.2	12.8	17.9
Tourism	4.2	3.0	-1.2	-28.4
Public Function	1.6	1.3	-0.3	-20.3
Agrarian Court	1.0	0.8	-0.2	-20.1
Federal Court	1.6	1.6	0.0	1.9
Public Security	34.5	31.8	-2.7	-7.8
Legal Council	0.5	0.1	-0.4	-80.6
CONACYT	16.2	15.5	-0.7	-4.4
General Branches	790.6	797.2	6.6	0.8
Entities under direct control	1,016.1	1,067.6	51.5	5.1
Pemex	366.2	384.4	18.2	5.0
CFE	208.6	220.3	11.7	5.6
LyFC	35.3	30.0	-5.3	-15.0
IMSS	313.4	320.4	7.0	2.2
ISSSTE	92.6	112.5	19.9	21.5
Transfers, subsidies and contributions	271.1	303.9	32.8	12.1

The Federation Expenditures Budget Project for the fiscal year 2010 will assign Ps. 1,370.4 billion for social development functions, which implies a real increase of 2.5 percent. The budget proposal considers an allocation of Ps. 149.7 billion for government functions, a 7.2 percent decrease with respect to that approved in 2009, while expenditures requested by Autonomous Organizations and the other branches of Government increases by 5.0 percent to Ps. 59.4 billion.



Programmable Expenditure of the Public Sector, 2009-2010 Functional Classification (Billion pesos of 2010)				
	2009	2010	Differences	
	PEF		Absolute	Absolute
Total	2,431.9	2,397.9	-34.0	-1.4
Powers and autonomous entities	56.6	59.4	2.8	5.0
INEGI	7.6	8.2	0.6	7.9
Federal Public Administration	2,319.1	2,330.2	11.2	0.5
Government	161.3	149.7	-11.6	-7.2
Social Development	1,337.0	1,370.4	33.4	2.5
Economic Development	820.8	810.2	-10.7	-1.3
Stabilization Funds	48.6	0.0	-48.6	-100.0

It is estimated that Federalized expenditures in 2010 will be Ps. 920.1 billion, almost equal to the approved amount in 2009 (higher by 0.3 percent), but will be Ps. 137.0 billion higher than that programmed for 2006.

Federal Transfers to Federal Entities, 2008-2009 Functional Classification (Billion pesos of 2010)				
	2009	2010	Differences	
	PEF		Absolute	Absolute
Total	917.6	920.1	2.5	0.3
Shared revenues	450.9	453.6	2.7	0.6
Transferred resources	466.7	466.5	-0.2	-0.1

Public Sector Borrowing Requirements for 2010

The Public Sector Borrowing Requirements (PSBR) calculation for 2010 will be adapted to account for the expected gain or loss due to financial intermediation measured as the increase or decrease of the development banks accounting capital during the year, instead of the net provision of credit. This is in order to recognize that the provision of bank credit is mostly supported by recoverable financial assets.

Taking into consideration the new methodology, the PSBR in 2010 will be 3.1 percent of GDP, 0.4 percentage points higher than the amount expected for 2009. The increase is due to the proposed transitory deficit for the Public Sector of Ps. 60 billion.

Public Sector Borrowing Requirements (% of GDP)			
Concept	2008	2009	Difference
I. Traditional balance	2.1	2.5	0.4
II Adjustments	0.6	0.6	-0.0
Borrowing requirements by PIDIREGAS	0.1	0.1	0.0
Borrowing requirements of IPAB	0.1	0.2	0.1
Adjustments to the budgetary registries	0.4	0.3	-0.1
Borrowers program	0.0	0.0	0.0
Development banks and promotion funds ^{1/}	0.0	0.0	0.0
III. RFSP (I+II)	2.8	3.1	0.3
Minus non-recurring income	3.8	3.1	0.7

^{1/} Includes the National Infrastructure Fund.

In this way, by the end of 2010 the historical balance of the Public Sector's Borrowing Requirements will be equivalent to 37.8 percent of GDP, 0.6 percentage points higher than the expected closing amount for 2009, calculated according to the new methodology.

Competitiveness Agenda

The growth experienced by the Mexican economy in recent years, even before the dramatic worsening of the international environment, is insufficient to advance quickly towards the goal of higher levels of development. It is therefore urgent to adopt an ambitious agenda of reforms that will bring improvements in competitiveness; increases in growth rates and job creation and to effectively reduce poverty.

The proposed agenda consists of actions in four areas:

- Improve the functioning of input markets to reduce costs and increase competitiveness. This aims to:
 - In labor markets, adjusting the legal framework to generate higher dynamism, encourage greater productivity and meet the needs of vulnerable groups. It will incorporate new forms of individual contracts, schemes that promote workers' incomes and productivity of enterprises and improving the administration and enforcement of justice. This can be achieved with strict adherence to the Constitution of the United Mexican States.
 - Actions in the Telecommunications Sector that will seek to increase investment and coverage as well as levels of technological convergence and competition. Regulation will be improved through measures such as opening to foreign direct investment, making adjustments to resale policies and adjustments to the concession scheme. Dark fiber and spectrum auctions will be made in order to develop infrastructure. The industry of radio and television will be transformed through measures such as digitization, migration from AM to FM and the granting

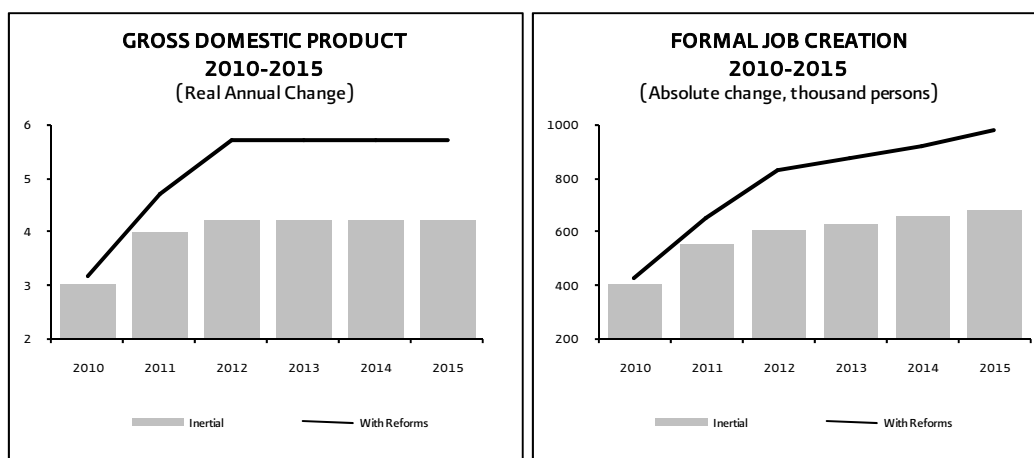


- of new concessions. The regulatory framework will adjust in order to improve the sector's institutional design.
- The performance of the energy sector will be reviewed to increase the competitiveness of the country, ensuring a reliable supply of inputs and reverse the decline in oil production. Measures will be taken in order to exploit the full potential of PEMEX's Reform. Measures to improve corporate governance of companies in the electricity sector, in order to achieve greater transparency, efficiency and accountability, will be promoted. Progress will be made in the use of renewable energy.
 - The impulse to Infrastructure will remain a priority for this administration. The allocations of public resources to this sector will be complemented by adjustments to its regulatory framework. A Public-Private Partnerships Law will be proposed which will encompass all the different articles related to the sector but which are currently scattered among a variety of jurisdictions, giving greater legal certainty. There shall be a dual tender scheme to exploit the synergies between the Roads and Bridges Law and the Public Works Law.
 - In order to promote a higher level of financial intermediation, new financial instruments such as mortgage backed bonds will be developed, and the legal framework for securitization, bank bankruptcies and Sofomes will be strengthened. In order to increase the returns of workers in the retirement savings system, we will continue working to reduce fees and allow investment strategies in productive projects. Changes to the regulatory framework of the development banks will be proposed with the objective of exploiting synergies between the different actors in the sector.
- Improve the institutional framework in which economic activity unfolds.
 - Reforms to the legal protection (amparo) procedure in tax matters, land and shelter for purpose will be proposed, in order to generate an environment of greater legal certainty. There will be a reform of commercial justice to achieve greater efficiency in the justice administration. Actions will be undertaken to strengthen and simplify public services, such as a reform of property registration procedures, the establishment of a complete regulatory revision and tax simplification.
 - Widen the markets for our products and services.
 - The Federal Competition Commission will be strengthened by establishing truly dissuasive sanctions and measures. The country's international trade will be diversified through increased trade integration with North America in sectors distinct from manufacturing one and measures to intensify the integration with other regions like Asia and South America including a Free Trade Agreement with Brazil will be pursued.
 - Promote those sectors that can have a higher impact on employment and poverty abatement

- Finally, a series of measures will be conducted to provide more growth opportunities to areas that are critical in terms of creating jobs and fighting poverty, such as in the rural sector, the tourism sector and the housing sector.

The deterioration of the international environment implies that the goals outlined in the National Development Plan in terms of economic growth and job creation for 2012 cannot be achieved in the absence of measures. It is considered that in an inertial scenario an annual growth rate of 4.2 percent would be observed in 2012, which implies the creation of close to 600,000 jobs.

To advance rapidly in terms of sustainable human development, it is necessary to implement the set of additional structural reforms mentioned. It is expected that the achievement of the agenda outlined above would lead to an additional increase in the growth rate of between 1.5 and 2.0 percent in 2012, leading to economic growth of close to 6 percent.



Final Considerations

The public finances have been deeply affected by the confluence of lower domestic economic activity, resulting from the international crisis, and the reduction in oil prices and production. These factors have led to the largest reduction in oil revenues and non-oil tax revenues in at least the last thirty years.

It is essential to carry out a tax reform that will enable us to confront these adverse circumstances, while at the same time help us offset the decline in oil revenues due to lower hydrocarbon production. The objective is to achieve the optimal combination of measures that preserves the maximum possible impulse to the economy and employment, without leading to questionings of the sustainability of the public finances in the medium term.



Our rates of economic growth and job creation are insufficient due to low competitiveness. Therefore, an agenda of actions in economic matters that lead to higher growth should also be prioritized; and they should respond to the criteria that the Government can contribute more by facilitating the activity of other economic actors -through an appropriate legal, administrative, and regulatory framework-, that through direct expenditures.

These reforms are also complementary: in the absence of healthy public finances, economic growth and investment are unlikely to increase even with reforms in favor of competitiveness and growth; and even though the sustainability in public finances is a necessary condition for accelerated growth, it is not sufficient.

Attaining the measures discussed will require a continuous and coordinated work with Congress. Both branches of Government have an enormous responsibility, and need to respond within a framework of dialogue and respect to achieve the consensus that will enable us to improve the welfare of all Mexicans.

As well, it is essential that the governments of states and municipalities join this effort for a better future. Of particular importance is that local governments contribute to facilitate the actions of the rest of the society in the context of its regulatory and executive faculties, and also carry out a process of rationalization, of greater efficiency and full transparency in the exercise of public expenditures.

Undoubtedly, this agenda of reforms constitutes a very ambitious program, but it is what the country is demanding at this moment in time. It is a program with a sense of urgency and long-term vision that will enable us to grow at rates of 6 percent per year by 2012, and that will be generating the jobs that are required by the new generations. On the eve of the commemorations of the Revolution's Centenary and the Independence's Bicentennial, we must be a generation that leads Mexico into a promising future.