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# Mexico Consensus Economic Forecast, Volume 16, Number 4

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## CONSENSUS ECONOMIC FORECAST

# MÉXICO

University of Texas at El Paso  
Border Region Modeling Project

## 4<sup>th</sup> Quarter 2013

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### Labor Code Reform Progress in Mexico

Mexico has a labor force of 52 million people, approximately 60 percent of the population aged 14 years or older. Although the official unemployment rate is relatively low at 5.4 percent, an astoundingly high 54.2 percent of the labor works in underground informal sectors of the economy. Informal sector jobs are defined as non-farm positions at companies that are not legally registered or jobs that do not accrue social security benefits. The Mexican Institute of Social Security (IMSS) provides social security services to 44 percent of the labor force. As of August 2013, 89 percent of the latter hold permanent positions while the rest have part-time or temporary jobs. Social security employment benefits include medical services, access to mortgage loans, and retirement pensions financed by employer, federal government, and worker contributions.

International comparative data also paint a bleak picture for Mexico. *The Global Competitiveness Report 2011-2012*, published by the World Economic Forum, ranks Aztec labor market competitiveness at 114 out of 142 countries included in the analysis. According to executives surveyed for the annual study, the most problematic issues facing businesses were highly restrictive labor regulations and tangled tax statutes. Mexico scored particularly poorly with respect to hiring and firing requirements. Red tape regulatory burdens associated with the latter badly hampered national labor market efficiency. Under these conditions, change was long overdue.

The first federal labor law was published in 1931 and lasted nearly 40 years with only minor modifications to some articles. The first major change to the law took place in 1970 and it lasted 42 years. Continued sub-par labor market performance eventually led to genuine labor code reforms being enacted on 30 November 2012 and going into effect 24 hours later on the first day of the Peña Nieto Administration. While yet to be fully implemented, the new legislation calls for major changes in three different areas.

The three most prominent areas of change in the new labor law: 1) productivity based wage increases; 2) outsourcing contract regulations; and 3) employee recruiting and termination processes. Wage increases and promotions are to now be based on training and productivity and no longer be a function of seniority. Outsourcing cannot be used as a mechanism for income tax evasion. Curtailing the prior practice of paying sub-contract workers primarily with untaxed employment benefits is expected to raise approximately \$2.6 billion pesos per year in new tax revenues. The most controversial provisions of the new labor law are the rules for hiring and firing. Initial appointments will involve temporary contracts that use trial periods and training programs for new workers. Companies will

evaluate worker performances before deciding whether to offer longer term contracts or to dismiss workers without any having to make any severance payments. Employers can now utilize email communication to notify employees about dismissals.

Perhaps the most controversial section of the labor reform is the hiring and firing process. Companies will evaluate worker performances based on probationary period assessments to decide whether to establish or terminate working relationships. The new Federal Labor Law defines two working relationship lengths: determined (temporary) and undetermined (permanent). Probationary assessment periods generally last 90 days. However, in cases when positions require specialized training programs, probationary periods can last 180 days. Workers will receive salaries and social security benefits during assessment periods. Once probationary periods are completed, if workers are not retained, employers can dismiss those persons without any further compensation. Initial probationary assessment periods cannot be extended. If working relationships continue, it means that workers have been hired for undetermined periods and worker starting dates will be identified as the beginning of the probationary periods.

In cases of unjustified dismissals, workers may appeal to the *Junta de Conciliación y Arbitraje* (Arbitration and Conciliation Council) for reinstatement or 90-day compensation severance packages. If employers cannot justify dismissals, back wages dating from the dismissal date up to a 365-day maximum period must be paid. If arbitration cases that last for extended periods, employers will have to pay interest costs of 2 percent for 15 months of salary, down from 38 months under the prior version of the law. The new law also allows attorneys and other authorities that promote actions increasing the length of the litigation process to be penalized. The new law kept unchanged the amount of additional compensation required to avoid reinstatement (Article 50). Workers with temporary working relationships of less than 365 days will receive compensation equal to half of the duration of the contracts. For temporary contracts of more than 365 days, workers will receive the equivalent of six months of salary for the first year and twenty days of salary for each remaining year. If working relationships are for indeterminate periods, dismissal compensation will be twenty days of salary for each year worked.

A central feature of the new law is the unemployment insurance program that will eventually be implemented. The objective of the new unemployment insurance program is to allow workers more time to search for formal sector jobs and thereby avoid falling into informality. The Federal Unemployment Insurance Law is scheduled to be implemented in 2016. It will establish monetary provisions for employees registered with the IMSS who lose their jobs but have worked for at least 24 months of the prior 36 months. Unemployment insurance payments will be defined on a scale of one to ten with respect to federally defined minimum wages and will decrease over the course of a six month period. Initial funding requirements for the unemployment insurance fund are estimated to lie between \$12 billion and \$40 billion pesos. Funds are to be partially obtained from worker housing account contributions to INFONAVIT. Additional funds are to be provided from general revenue sources within the federal budget of 2014.

As justification for reforming the labor code, the government argues that it will increase labor market flexibility and increase the number of formal sector jobs. Worker groups have argued that the new law favors employers by worsening employee salaries and benefits. Because the unemployment insurance fund will not even be in place until 2016, it is still too early to render a verdict on this effort to cure the Aztec strain of Euroscelerosis that has long affected labor market performance in Mexico. With respect to improving overall productivity and efficiency beyond just the labor market, more steps must still be completed.

Other policy innovations yet to be approved and implemented include financial, energy, telecommunications, and education reform packages. The recently enacted fiscal reform will probably affect labor costs and may impact the rate job creation. Of particular concern are changes to labor income taxes and the elimination of the tax deductibility of social security contributions paid by companies. As a consequence of these changes, formal sector labor force costs of IMSS registered workers are likely to increase. The net effect of both measures may be lower net wages for formal sector workers and, ironically, companies may still remain leery of increasing payrolls.

Mexico faces a number of serious economic problems. Among the most prominent is a poverty rate estimated at 45.5 percent of the national population. That is represents approximately 53.3 million people, a number that slightly exceeds the total labor force. Any permanent progress toward reducing the poverty rate will require a more efficient labor market in which private sector companies take advantage of the human resource endowments available in Mexico. It will also require additional structural reforms in other sectors of the economy. The labor reforms enacted one year ago represent a step in the right direction but have yet to be fully implemented. It is too soon to assess whether the new law helps overcome labor market stagnation in Mexico. To a large extent, though, the success of the Peña Nieto administration hinges upon it.

## 4<sup>th</sup> Quarter 2013 Summary

### Looking Forward to a Better Year

Real GDP grew by only 1.3 percent in the third quarter of 2013 compared to the same period one year ago. GDP performance in the first two quarters of the year was similarly disappointing. The consensus forecast calls for a GDP growth rate of just 1.2 percent for the year. Panelist estimates are tightly clustered around that figure.

The predicted rate of growth in private consumption, though unimpressive, is somewhat higher than expected growth rates for the other components of GDP. Continued expansion in formal sector employment may help stabilize private consumption, though it is unclear to what extent consumers have curbed spending in view of weakened overall economic conditions. Panelist forecasts of this year's growth in private consumption span a wide range, from 0.7 percent to 3.6 percent. The average forecast is 2.1 percent.

Growth in government consumption was interrupted as a result of the transition to a new presidential administration during the first part of 2013. Even though the government would like to stimulate the economy, public spending has been hampered by lethargic tax collections. The average estimate of government spending growth for the year as a whole is 1.1 percent. This would represent the lowest year-over-year change in government consumption since 2003.

Total investment is an area of particular weakness for Mexico's economy this year due, in part, to a downturn in construction activity. All but one of the panelists revised their investment projections downward this quarter. The consensus forecast now predicts that investment will grow by a mere 1.0 percent in 2013.

Weak demand for Mexico's exports is one of the factors that reduced GDP growth in the first half of the year. More recently, however, a lower relative value of the peso and better economic conditions among some trading partners have led to higher export volumes. The consensus forecast of export growth in 2013 now stands at 2.9 percent, which represents a slight upward revision from last quarter's estimate. Similarly, the real value of imports is expected to grow by 3.0 percent.

Despite recent spikes in agricultural commodity and electricity prices, inflation is much less problematic in Mexico than it is elsewhere in Latin America. Careful monetary policy, relatively weak aggregate demand, plus the absence of severe or persistent supply shocks will help prices to remain stable. Only one panelist forecasts inflation to exceed 4 percent in 2013. The consensus forecast calls for 3.9 percent inflation.

The peso/dollar exchange rate has been relatively stable in recent months and the consensus exchange rate forecast for this quarter is only marginally higher than last quarter's forecast. The average of panelist predictions is 12.87 pesos per dollar. Interest rates have fallen in reaction to adverse overall economic conditions. Most panelists expect that the yield on 28-day CETES will be very near the rate of inflation. According to the consensus forecast, the rate of return on these CETES will average 3.8 percent in 2013.

Economic conditions are expected to improve in 2014 with GDP predicted to grow by 3.0 percent. Similarly, private consumption is forecast to grow by 3.1 percent. Rather than being a drag on the economy, government consumption is expected to grow at a healthy clip of 3.1 percent in 2014. In light of better economic prospects and still relatively low interest rates, investment spending is also expected to recover, growing at a projected rate of 4.2 percent.

Global demand for Mexican goods and services is also predicted to improve in 2014, with exports estimated to grow at a rate of 4.4 percent. However, most of the panelists predict that imports will increase at a faster rate than exports. The consensus forecast calls for 5.3 percent growth in imports. Partly as a result of the higher tax rates contemplated by the recent fiscal reform, inflation is expected to pick up slightly next year. The consensus inflation rate forecast is 4.0 percent. The exchange rate and the yield on 28-day CETES are expected to remain unchanged in 2014 at 12.87 pesos per dollar and 3.8 percent, respectively.

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**2013 Mexico Consensus Economic Forecast**

|   | Annual Percent Change, 2013 from 2012 |                     |                        |                  |         |         | Annual Average       |               |              |
|---|---------------------------------------|---------------------|------------------------|------------------|---------|---------|----------------------|---------------|--------------|
|   | GDP                                   | Private Consumption | Government Consumption | Total Investment | Exports | Imports | Consumer Price Index | Exchange Rate | CETES 28 Day |
| American Chamber Mexico                   | 1.2                                   | 2.3                 | -0.1                   | -1.0             | 2.5     | 3.5     | 3.8                  | 12.77         | 3.8          |
| BBVA Bancomer                             | 1.2                                   | 0.7                 | 1.6                    | 0.2              | 3.4     | 1.9     | 3.9                  | 12.75         | 3.8          |
| Wells Fargo Bank                          | 1.1                                   | 2.4                 | 1.1                    | 0.8              | 2.1     | 1.9     | 3.8                  | 12.78         | 3.8          |
| Center for Economic Forecasting of Mexico | NA                                    | NA                  | NA                     | NA               | NA      | NA      | NA                   | NA            | NA           |
| UACJ                                      | 1.3                                   | 2.5                 | 1.2                    | 2.0              | 3.0     | 3.0     | 3.8                  | 13.00         | 3.4          |
| ITESM                                     | 1.2                                   | 2.0                 | 1.5                    | 2.0              | 3.0     | 3.5     | 3.7                  | 12.90         | 3.5          |
| COLEF                                     | 1.1                                   | 1.4                 | 1.8                    | 2.0              | 2.3     | 3.0     | 5.0                  | 13.20         | 4.7          |
| UAdeC                                     | 1.2                                   | 2.3                 | 1.1                    | 1.1              | 2.4     | 3.3     | 3.7                  | 12.80         | 3.6          |
| UANL                                      | 1.2                                   | 3.6                 | 1.0                    | 1.3              | 4.7     | 4.1     | 3.8                  | 12.77         | 3.8          |
| Consensus -- this quarter                 | 1.2                                   | 2.1                 | 1.1                    | 1.0              | 2.9     | 3.0     | 3.9                  | 12.87         | 3.8          |
| -- last quarter                           | 1.8                                   | 2.3                 | 1.2                    | 2.3              | 2.7     | 3.0     | 3.7                  | 12.84         | 3.9          |

**2014 Mexico Consensus Economic Forecast**

|   | Annual Percent Change, 2014 from 2013 |                     |                        |                  |         |         | Annual Average       |               |              |
|---|---------------------------------------|---------------------|------------------------|------------------|---------|---------|----------------------|---------------|--------------|
|   | GDP                                   | Private Consumption | Government Consumption | Total Investment | Exports | Imports | Consumer Price Index | Exchange Rate | CETES 28 Day |
| American Chamber Mexico                   | 2.9                                   | 2.9                 | 5.7                    | 4.0              | 5.4     | 7.1     | 4.2                  | 12.88         | 3.4          |
| BBVA Bancomer                             | 3.1                                   | 3.5                 | 2.8                    | 6.5              | 2.6     | 4.3     | 3.6                  | 12.80         | 3.5          |
| Wells Fargo Bank                          | 2.1                                   | 2.4                 | 2.0                    | 2.3              | 3.2     | 3.3     | 4.2                  | 12.96         | 3.8          |
| Center for Economic Forecasting of Mexico | NA                                    | NA                  | NA                     | NA               | NA      | NA      | NA                   | NA            | NA           |
| UACJ                                      | 3.0                                   | 3.0                 | 2.0                    | 3.0              | 4.0     | 4.0     | 4.0                  | 12.50         | 3.5          |
| ITESM                                     | 3.3                                   | 3.2                 | 2.0                    | 3.5              | 3.0     | 3.5     | 3.9                  | 12.80         | 3.7          |
| COLEF                                     | 2.3                                   | 2.6                 | 3.4                    | 4.1              | 4.8     | 5.8     | 4.6                  | 13.35         | 4.9          |
| UAdeC                                     | 3.8                                   | 3.0                 | 4.5                    | 6.5              | 6.5     | 8.0     | 3.5                  | 12.80         | 3.8          |
| UANL                                      | 3.5                                   | 4.5                 | 2.8                    | 3.6              | 5.8     | 6.7     | 3.8                  | 12.85         | 3.6          |
| Consensus -- this quarter                 | 3.0                                   | 3.1                 | 3.1                    | 4.2              | 4.4     | 5.3     | 4.0                  | 12.87         | 3.8          |
| -- last quarter                           | 3.3                                   | 3.1                 | 2.6                    | 4.8              | 4.6     | 4.7     | 3.8                  | 12.90         | 4.0          |

| Historical Data       | Annual Averages                     |   |  |   |   |   |   |  |                    |
|-----------------------|-------------------------------------|---|--|---|---|---|---|--|--------------------|
|                       | GDP<br>(2008<br>Pesos,<br>billions) | Private<br>Consumption<br>(2008 Pesos,<br>billions) | Government<br>Consumption<br>(2008 Pesos,<br>billions) | Total<br>Investment<br>(2008<br>Pesos,<br>billions) | Exports<br>(2008<br>Pesos,<br>billions) | Imports<br>(2008<br>Pesos,<br>billions) | Consumer<br>Price<br>Index Dec<br>2010 =<br>100 | Nominal<br>Exchange<br>Rate<br>Pesos/<br>Dollars | CETES<br>28<br>Day |
| 2012                  | 13,263.6                            | 8,866.1   | 1,468.6  | 2,934.6   | 4,167.9                                 | 4,178.7                                 | 105.20  | 13.17  | 4.24               |
| <i>Percent Change</i> | <i>3.91%</i>                        | <i>4.68%</i>  | <i>3.28%</i>   | <i>4.56%</i>  | <i>5.92%</i>                            | <i>5.37%</i>                            | <i>4.11%</i>                                    | <i>6.01%</i>                                     |                    |
| 2011                  | 12,764.4                            | 8,469.8   | 1,422.0  | 2,806.5   | 3,935.1                                 | 3,965.7                                 | 101.04  | 12.42  | 4.24               |
| <i>Percent Change</i> | <i>3.96%</i>                        | <i>4.90%</i>  | <i>2.51%</i>   | <i>7.91%</i>  | <i>8.22%</i>                            | <i>8.01%</i>                            | <i>3.41%</i>                                    | <i>-1.68%</i>                                    |                    |
| 2010                  | 12,277.7                            | 8,074.1   | 1,387.1  | 2,600.8   | 3,636.4                                 | 3,671.4                                 | 97.71   | 12.64  | 4.40               |
| <i>Percent Change</i> | <i>5.11%</i>                        | <i>5.28%</i>  | <i>1.71%</i>   | <i>1.27%</i>  | <i>20.55%</i>                           | <i>20.46%</i>                           | <i>4.16%</i>                                    | <i>-6.49%</i>                                    |                    |
| 2009                  | 11,680.7                            | 7,669.3   | 1,363.8  | 2,568.1   | 3,016.6                                 | 3,047.8                                 | 93.81   | 13.51  | 5.39               |
| <i>Percent Change</i> | <i>-4.70%</i>                       | <i>-6.46%</i>                                       | <i>2.25%</i>   | <i>-9.27%</i>                                       | <i>-11.78%</i>                          | <i>-17.59%</i>                          | <i>5.30%</i>                                    | <i>21.42%</i>                                    |                    |
| 2008                  | 12,256.9                            | 8,198.8   | 1,333.8  | 2,830.4   | 3,419.4                                 | 3,698.3                                 | 89.09   | 11.13  | 7.68               |
| <i>Percent Change</i> | <i>1.40%</i>                        | <i>1.90%</i>  | <i>3.03%</i>   | <i>4.95%</i>  | <i>-1.35%</i>                           | <i>4.40%</i>                            | <i>5.12%</i>                                    | <i>1.84%</i>                                     |                    |
| 2007                  | 12,087.6                            | 8,046.2   | 1,294.5  | 2,696.8   | 3,466.2                                 | 3,542.3                                 | 84.75   | 10.93  | 7.19               |
| <i>Percent Change</i> | <i>3.15%</i>                        | <i>3.04%</i>  | <i>2.45%</i>   | <i>5.99%</i>  | <i>3.65%</i>                            | <i>5.93%</i>                            | <i>3.97%</i>                                    | <i>0.27%</i>                                     |                    |
| 2006                  | 11,718.7                            | 7,809.0   | 1,263.5  | 2,544.4   | 3,344.2                                 | 3,344.0                                 | 81.52   | 10.90  | 7.19               |
| <i>Percent Change</i> | <i>5.00%</i>                        | <i>5.52%</i>  | <i>3.40%</i>   | <i>8.69%</i>  | <i>7.67%</i>                            | <i>10.19%</i>                           | <i>3.63%</i>                                    | <i>0.01%</i>                                     |                    |
| 2005                  | 11,160.5                            | 7,400.8   | 1,222.0  | 2,341.0   | 3,106.0                                 | 3,034.7                                 | 78.66   | 10.90  | 9.19               |
| <i>Percent Change</i> | <i>3.03%</i>                        | <i>4.40%</i>  | <i>3.05%</i>   | <i>5.90%</i>  | <i>5.71%</i>                            | <i>7.71%</i>                            | <i>3.99%</i>                                    | <i>-3.44%</i>                                    |                    |
| 2004                  | 10,832.0                            | 7,088.9   | 1,185.9  | 2,210.5   | 2,938.2                                 | 2,817.5                                 | 75.64   | 11.29  | 6.84               |
| <i>Percent Change</i> | <i>4.30%</i>                        | <i>5.57%</i>  | <i>2.39%</i>   | <i>7.52%</i>  | <i>9.13%</i>                            | <i>9.71%</i>                            | <i>4.69%</i>                                    | <i>4.61%</i>                                     |                    |
| 2003                  | 10,385.9                            | 6,715.1   | 1,158.2  | 2,055.9   | 2,692.3                                 | 2,568.1                                 | 72.26   | 10.79  | 6.24               |
| <i>Percent Change</i> | <i>1.42%</i>                        | <i>1.11%</i>  | <i>-0.54%</i>  | <i>2.97%</i>  | <i>0.89%</i>                            | <i>2.39%</i>                            | <i>4.55%</i>                                    | <i>12.04%</i>                                    |                    |
| 2002                  | 10,240.2                            | 6,641.5   | 1,164.5  | 1,996.7   | 2,668.6                                 | 2,508.1                                 | 69.11   | 9.63   | 7.08               |
| <i>Percent Change</i> | <i>0.13%</i>                        | <i>1.39%</i>  | <i>-1.19%</i>  | <i>0.53%</i>  | <i>2.06%</i>                            | <i>2.74%</i>                            | <i>5.03%</i>                                    | <i>3.10%</i>                                     |                    |
| 2001                  | 10,226.7                            | 6,550.2   | 1,178.6  | 1,986.1   | 2,614.8                                 | 2,441.2                                 | 65.80   | 9.34   | 11.26              |
| <i>Percent Change</i> | <i>-0.61%</i>                       | <i>2.01%</i>  | <i>-3.13%</i>  | <i>-3.30%</i>                                       | <i>-3.40%</i>                           | <i>-0.60%</i>                           | <i>6.37%</i>                                    | <i>-1.27%</i>                                    |                    |
| 2000                  | 10,289.0                            | 6,420.9   | 1,216.7  | 2,053.8   | 2,706.7                                 | 2,456.0                                 | 61.86   | 9.46   | 15.27              |

Note: 2012 data are preliminary and subject to revision

\*GDP: Producto Interno Bruto, INEGI, 2008 Pesos

\*Private Consumption: Consumo Privado, INEGI, 2008 Pesos

\*Government Consumption: Consumo de Gobierno, INEGI, 2008 Pesos

\*Total Investment: Formacion bruta de capital fijo, INEGI, 2008 Pesos

\*Exports: Exportacion de bienes y servicios, INEGI, 2008 Pesos

\*Imports: Importacion de bienes y servicios, INEGI, 2008 Pesos

\*CPI, Banco de Mexico, Annual Average, Base = Dec 2010

\*Exchange Rate, Banco de Mexico, Peso-to-dollar, Fecha de Liquidacion, Annual Average

\*CETES 28 Days, Banco de Mexico, Annual Average

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