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Sharp Drop in Tax Collections in Mexico Reflects Impact of Economic Crisis

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According to a report released by the Finance Secretariat (SHCP) in mid-November, the federal government's tax collections during January-September of this year are down by about one-fifth from last year, due mainly to the economic crisis that followed the devaluation of the peso in late 1994. The SHCP report said that the government collected about US$125 billion nuevo pesos (US $16.1 billion) in taxes in the first nine months of the year, a decline of 21% in real terms from the same period last year. The SHCP statistics, presented to the Chamber of Deputies, showed that the government's total revenues which include both tax collections and funds obtained from sales of products and licenses were down about 7.1% in real terms. According to the report, the decline in tax revenues during January-September was partially offset by a 33% increase of non-tax revenues such as licenses and other fees.

The decline in tax revenues came despite new programs implemented by President Ernesto Zedillo's administration to widen the country's tax base. Indeed, according to El Financiero International weekly business newspaper, the decline in tax collections is greater than during the periods that followed the economic declines of 1982 and 1986. According to the SHCP, revenues from the value-added tax (impuesto al valor agregado, IVA) approached 36 billion nuevo pesos (US $4.6 billion), a slight decline from a year ago. However, the decline was much less than originally expected at the beginning of this year as a result of the Zedillo administration's decision to increase the IVA from 10% to 15%, which took effect on April 1 (see SourceMex, 03/15/95).

Finance Secretary Guillermo Ortiz noted that without the increase in IVA enacted in April, by the end of the year, revenue from this tax would have declined by about 19% compared with 1994. Similarly, collection of income taxes (Impuesto Sobre la Renta, ISR) in the January-September period declined by almost 20% in real terms compared with same period last year, dropping to about 58 billion nuevo pesos (US$7.5 billion). In the past, income taxes have accounted for 40% of Mexico's total tax revenue. In the first nine months of this year, however, income taxes represented only 33% of total tax revenue. The administration maintains that the high taxes are necessary, at least for now, to allow the government to continue essential services. Indeed, many economists point out that next year's budget will be the lowest in modern history, which could present an obstacle in the government's efforts to reactivate the economy. For 1996, the government has proposed expenditures of 553.7 billion nuevo pesos (US$71.4 billion), a decline of 0.4% in real terms from 1994.

On the other hand, organizations such as the confederation of national chambers of commerce (Confederacion Nacional de Camaras de Comercio, Concanaco) have argued that the Mexican economy will not recover unless the Zedillo administration lowers the IVA and the ISR. For example, in a report released in November, Concanaco blamed the 7% decline in GDP during January-September on the IVA increase, which forced many companies to go bankrupt. Still, Ortiz and other administration officials maintain that the government is making an effort to reduce

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unnecessary expenditures. At the same time, Ortiz emphasized that despite the administration's reduced budget for next year, spending on education, health, and public works will be increased, not reduced. He said the administration has proposed increases of 3.9% for public works and infrastructure projects and 2.5% for social programs. In addition, the administration proposed an increase of 24% in spending for agricultural programs and general rural development.

Furthermore, Ortiz noted that the economic recovery expected in 1996 in theory should help boost tax revenues next year. The Zedillo administration and private economists have forecast a GDP growth of 2% to 3% for all of 1996, compared with projections of a GDP decline of at least 5% in 1995. In November, the SHCP reported that Mexico's GDP declined by a whopping 9.6% for July-September, resulting in a total GDP decline of 7% for January-September. According to Ortiz, the Zedillo administration projects that total revenues next year will only decline by about 0.3% from this year. Still, he projected that tax revenues in 1996 would amount to about 8.63% of the country's GDP, still below the 8.9% estimated for 1995. He forecast that collections will reach 90 billion nuevo pesos (US$11.6 billion) from the ISR and 78.7 billion nuevo pesos (US$10.1 billion) from the IVA.

Speaking at a meeting of business owners and industrial leaders in early December, Ortiz promised that during the first half of the year, the administration would devote 43% of its budget toward programs designed to reactivate Mexico's productive and manufacturing capacity. The Zedillo administration is also using targeted tax breaks to support small businesses and promote the return of capital to Mexico. For example, at the end of October, the administration announced a plan to specifically assist automobile manufacturers. Under this plan, the government eliminated sales taxes on the purchase of any automobiles purchased through year-end 1996. In conjunction, the administration said small-and medium-sized businesses that acquire new vehicles would be allowed a deduction of up to 71% of the value of the car in the next tax payment.

The Zedillo administration has also proposed some reductions in taxes to encourage Mexican and foreign investors to repatriate their capital. Under the initiative, the Zedillo administration will charge a tax rate of only 0.5% for businesses or individuals who return their capital from overseas. The initiative applies only to capital taken out of the country before Sept. 30 of this year. However, this tax break will be in effect through March 31, 1996. After that date, businesses and individuals would have to pay a 1% rate for repatriated capital. According to a prepared statement from the SHCP, even with the increase after March 30, the administration will continue to develop strong incentives for Mexicans and foreigners to return capital to Mexico. "The aspiration is that repatriated capital will contribute to the growth of productive investment in the country and fortify the national currency," the SHCP said.

The concerted effort to attract capital back to Mexico was initiated by former president Carlos Salinas de Gortari. To varying degrees, the government succeeded in attracting capital back to the country between 1989 and 1993. The Zedillo plan, however, provides a much lower tax rate than the plans offered during the Salinas years. Indeed, Zedillo has been forced to offer a more attractive incentive to Mexican and foreign investors, given the massive flight of capital over the past two years. According to the World Bank, political and economic instability since January of 1994 and in particular the devaluation of the peso in December of last year caused a total of US$4.1 billion in capital flight over the two-year period. [Note: Peso-dollar conversions in this article are based on

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the Interbank rate in effect on Dec. 12, reported at 7.75 nuevo pesos per US$1.00] (Sources: Journal of Commerce, 10/23/95; Agence France-Presse, 10/31/95; Inter Press Service, 10/19/95, 11/15/95; Reforma, 11/15/95; El Financiero International, 11/20/95; Associated Press-Dow Jones, 12/11/95; Notimex, 12/12/95; Excelsior, 10/20/95, 11/15/95, 12/12/95, 12/13/95)

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