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President, Senate Form Panel to Propose Reforms to Outdated Tax System

by LADB Staff
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President Vicente Fox's administration and the major political parties have created a 19-member panel to draft a preliminary plan to overhaul Mexico's outdated tax code. Participants in the panel include members of the three major political parties, representatives of the Secretaria de Hacienda y Credito Publico (SHCP), chief central bank governor Guillermo Ortiz Martinez, and several economists and academics.

One goal of the panel, over which the Senate will preside, is to develop a blueprint with concrete proposals for the Congress to consider in the next legislative session. "We are targeting the creation of a new comprehensive tax reform by Sept. 30 at the latest," said Sen. Fauzi Hamdan, a member of Fox's pro-business Partido Accion Nacional (PAN).

Sen. Demetrio Sodi de la Tijera of the center-left Partido de la Revolucion Democratica (PRD) said his Senate colleagues agree that tax reform should take precedence over political, energy, or any other reform during the next session of Congress. "Fiscal reform is the only one that will directly promote the development of the country," said Sodi.

Goal is improved tax collection

The panel will propose tax-code changes that will help the government improve tax collection. Some estimates show evasion on the value-added tax (impuesto al valor agregado, IVA) and the income tax (impuesto sobre la renta, ISR) amounts to 600 billion pesos (US$56.1 billion) annually.

Because of this high evasion, Mexico's tax-collection rate stands at only 11.5% of GDP. This is a slight improvement over the 10.5% of GDP a few years ago, but still one of the lowest rates in Latin America (see SourceMex, 2002-11-13). Low tax-collection rates have forced the government to rely on oil-export revenues to fund government programs. This has benefitted Mexico this year because international oil prices have remained high.

The state-run oil company PEMEX reports that revenues from oil exports surpassed 22 billion pesos (US$2.1 billion) because the average price of crude oil has topped projections by an average of US$4.60 per barrel. The oil market is volatile, however, and a sustained price decline forced the Mexican government to cut expenditures on several occasions in recent years (see SourceMex, 1998-07-15, 1999-03-10, 2001-05-16 and 2002-04-10).

Sen. Alejandro Gutierrez of the former governing Partido Revolucionario Institucional (PRI) said the proposed changes to the tax code will not only give the government more powers to collect taxes and prosecute evaders but will also simplify procedures for tax payment and boost legal protections for taxpayers who comply with the law. "We have to create more certainty to the fiscal structures," said
Gutierrez. "Business sectors are unable to make long-term plans because they do not know what rules will be in place each year."

Some tax-related issues could cause divisions

While broad agreement exists on the need to improve tax collection, the major political parties and the administration will have to reconcile differences in other areas related to fiscal reform. For example, Sodi is promoting the longstanding position of the PRD and many members of the PRI that improved tax collection is sufficient to boost government revenues to adequate levels. This conflicts with the traditional position of the Fox administration, most members of the PAN, and some members of the PRI that an increase in the IVA is warranted, especially if the administration goes along with proposals by the business sector to reduce the ISR and other business-related taxes.

The administration and the PAN have supported proposals to impose an IVA on sales of food and medicines, which are currently exempt from this tax. Fox was rebuffed when he attempted to push through such a proposal at the start of 2002 (see SourceMex, 2002-01-09 and 2002-04-10).

There are some differences in the PRI on how to treat the IVA in the tax reform. Some members favor reducing the IVA from its current level of 15% to 10% or 12% but applying the tax to food and medicines. Their plan would then create exemptions for the segments of the population with the lowest incomes, who would not have to pay the tax on food and medicine. This plan, said proponent Francisco Suarez Davila, would force the higher-income segments of the population to pay taxes on food and medicine. The proposal is supported by economists like Fausto Hernandez Trillo of the Centro de Investigacion y Docencia Economica (CIDE), who say tax collection would increase by at least 1.5% of GDP with an across-the-board IVA.

Other PRI members say this plan is not workable, especially during the country's economic crisis. "Now is not the time to impose taxes on food and medicines with unemployment at such high levels," said Sen. Gutierrez, who also raised concerns about the impact on the tax on the ailing agriculture sector. Still, Hamdan said the panel will try to restructure the IVA, the ISR, and other special taxes without increasing the tax burden on Mexican citizens.

Governors also weigh in on tax debate

Tax reform is also a major concern for the Confederacion Nacional de Gobernadores (CONAGO), comprising the 22 governors affiliated with the PRI and the PRD, including Mexico City Mayor Andres Manuel Lopez Obrador. CONAGO is especially interested in pushing through proposals that would give state and municipal governments greater taxation powers. "The current centralized system of tax collection is no longer useful," said Lopez Obrador, an influential member of CONAGO.

The Mexico City mayor said the move would not necessarily increase taxes for Mexican citizens because the governors have proposed compensating for the state and local collections with a reduction in federal taxes. "We are seeking a more equitable distribution of taxes," said Lopez Obrador. The governors' association has been at odds with Fox regarding the allocation of federal funds to states. In 2002, the president angered the association when he reduced federal allocations to states because of a federal budget shortfall (see SourceMex, 2002-10-30).
To make up for past shortfalls, CONAGO has requested a 2.5% increase in the next budget for the state Programa de Apoyo para el Fortalecimiento de las Entidades Federativas (PAFEF). This would amount to 5.3 billion pesos (US$500 million) above the 17 billion pesos (US$1.5 billion) projected for the fiscal year.

In an effort to add their voice to the tax debate, the PRI and PRD governors have proposed a national fiscal-reform convention, which would take place in two phases in February and July of 2004. The plan, presented as a resolution at the end of the annual CONAGO meeting in San Luis Potosi in late July, proposed to invite President Fox, Supreme Court Chief Justice Mariano Azuela, and the legislative leaders of the federal Congress and of all 32 state legislatures to discuss comprehensive changes to the tax code.

The CONAGO proposal initially received a positive reaction from Fox and key legislative leaders. "We are very interested in this invitation," said Fox. "We share the governors' concerns about the problems with our tax system and their proposal to address the problem in a comprehensive manner."

The president, however, asked CONAGO to give the administration some time to consider logistics and to come up with proposals for implementing a tax reform. Also expressing support for the proposal were Senate leaders Enrique Jackson Ramirez of the PRI, Diego Fernandez de Cevallos of the PAN, Jesus Ortega of the PRD, and Gloria Lavara Mejia of the Partido Verde Ecologista Mexicano (PVEM).

The nine PAN governors are also studying the CONAGO proposal and are expected to issue their own recommendations to the party's executive committee (comite ejecutivo nacional, CEN). PAN president Luis Felipe Bravo Mena said this will be incorporated into the proposals presented by the party to Fox. The governors' proposal, however, has met resistance among some members of the PAN. "The 'responsible federalism' proposed by the PAN should not allow a handful of governors to impose conditions on the entire country," said PAN Deputy-elect German Martinez. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Aug. 6, reported at 10.69 pesos per US$1.00] (Sources: CNI en Linea, 07/30/03, 07/31/03; La Cronica de Hoy, La Jornada, 07/31/03; El Financiero, 07/10/03, 07/15/03, 07/31/03, 08/01/03; Unomasuno, 07/10/03, 07/30/03, 08/01/03; Notimex, 07/15/03, 07/30/03, 08/04/03; Milenio Diario, 07/16/03, 07/21/03, 07/23/03, 07/29/03, 08/04/03; El Sol de Mexico, 07/18/03, 07/31/03; El Universal, 07/24/03, 07/29/03, 07/31/03, 08/04/03, 08/05/03; Reforma, 07/15/03, 07/18/03, 07/29-31/03, 08/01/03, 08/04/03, 08/06/03)

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