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Congress Turns Down President Fox's Proposal to Tax Food, Medicines

by LADB Staff
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At no time has the impact of the 2003 midterm election been more apparent than in the recent vote on President Vicente Fox's tax-reform package in the Chamber of Deputies. Fox's package, supported by the president's Partido Accion Nacional (PAN) and a small faction of the former governing Partido Revolucionario Institucional (PRI), lost by a narrow margin of 251-234 in a very tense session on Dec. 11. The opposition comprised more than three-quarters of the PRI members in the lower house, the entire delegation of the center-left Partido de la Revolucion Democratica (PRD), and members of three smaller parties.

In addition to its own members, the PAN could only muster support from one-fourth of the members of the PRI delegation. These members were loyal to ousted legislative floor leader Elba Esther Gordillo, who was booted out for her outspoken support of Fox's tax plan (see SourceMex, 2003-12-03). The Fox-Gordillo plan also had the support of 15 of the 17 PRI governors, but their advocacy did little to sway legislators from their party.

The strength of the opposition to the tax-reform package was rooted in the July 6 midterm election, where the PAN lost more than 50 seats to the PRI and the PRD (see SourceMex, 2003-07-09). Fox's tax plan would have stood a better chance of passage if the PAN had retained its 206 seats in the lower house, which the party attained as part of the 2000 election (see SourceMex, 2000-07-05).

To make matters worse, the PAN lost two additional seats that it had won in the July 2003 vote. In makeup elections in mid-December, the PAN lost a seat in Torreon, Coahuila state, to the PRI, and a seat in Zamora, Michoacan state, to the PRD. The makeup elections were held after electoral authorities accepted complaints from opposition parties of campaign irregularities in the July election.

Proposal to tax food, medicines sinks Fox plan

Fox's controversial tax plan was opposed by many legislators because it contained a proposal to extend a uniform 8% value-added tax (impuesto al valor agregado, IVA) on all products, including items previously exempt, such as food, medicines, books, private school tuition, and agricultural equipment.

Many PRI and PRD legislators said the IVA would have burdened the lower-income segments of the population. The Fox government and the Gordillo faction countered that the tax would have boosted revenues by 100 billion pesos (US$8.9 billion) in 2004, which would have helped the government increase expenditures on social-assistance programs. "Those who voted against this reform have voted to delay the solution to the nation's social problems," Fox said.
The president pledged to salvage his fiscal-reform proposals in Congress and repeated his threat to veto "populist" alternatives aimed at winning votes. The PAN delegation in the lower house, with the support of the Gordillo faction, resurrected a new version of the defeated tax-reform plan at a special session that began on Dec. 16. The new version proposes an 13% IVA on most products, but only 6% on food and medicine.

The PRI and PRD threatened to sink the new proposal, calling any tax on food and medicines unacceptable. Furthermore, PRD legislators said the move to bring back a proposal so similar to the one that was defeated could be a violation of the Mexican Constitution. "It is arrogant to present the same proposal that was defeated by the majority of the members of the Chamber of Deputies," said PRD Deputy Alfonso Ramirez Cuellar. PRD Deputy Emilio Serrano Jimenez was less diplomatic.

In a radio interview, he called for the death penalty for anyone who promotes a tax reform that will harm the poorest sectors of the country. The PRD immediately distanced itself from Serrano. "The PRD opposes any opinions of this sort, which violate the principles of tolerance and peaceful coexistence in Mexico," said PRD Deputy Inti Munoz.

**Alternate tax plan proposed in Congress**

Critics of the Fox-Gordillo plan acknowledged that some sort of tax reform would be needed to go along with the 2004 budget, which by law must be approved by Dec. 31. Legislators were unable to complete the budget legislation by the end of their regular session on Dec. 15 and were forced to start a special session Dec. 16.

The Fox administration has proposed a budget of 1.6 trillion pesos (US$142 billion), slightly higher than last year's budget of 1.5 trillion pesos (US$133 billion) but actually about 5% lower in real terms. This budget does not incorporate revenues that would have been obtained from the tax plan.

As a substitute for the Fox-Gordillo plan, a group of legislators from four of the five parties represented in the lower house, including a PAN representative, drafted a fiscal plan to boost government coffers by an additional 120 billion pesos (US$10.6 billion) beyond the projections by the Fox government in its alternate plan, which excludes tax reform. A key element of the plan is to increase tax-collection efficiency.

The proposal also bases a projection for increased revenues on a more optimistic estimate for oil exports than the Fox administration had originally forecast. The Secretaria de Hacienda y Credito Publico (SCHP) immediately rejected the substitute proposal because its revenue-collection mechanisms are less certain than an outright tax increase.

**Ousted PRI leader forms new faction in Congress**

The tax-reform vote also helped end the uncertainty regarding the PRI leadership in the lower house. Gordillo submitted her resignation as PRI leader shortly after the defeat of the plan sponsored jointly by her faction and the PAN, thus ending a standoff with Emilio Chuayffet about who would lead the PRI legislators. Gordillo’s outspoken support for Fox’s plan did not sit well with a large faction of the PRI, which opted to seek her removal and replace her with Chuayffet (see SourceMex, 2003-12-03).
At a press conference announcing her decision to step down, Gordillo directed most of her anger at Madrazo rather than Chuayffet. She called the party president a "liar" and a "traitor" for his conflicting positions regarding tax reform. Madrazo had initially offered support for the Fox-Gordillo tax-reform plan, but later changed his tune and helped lead the opposition to the proposal.

Some analysts said Madrazo's position change was directly related to his ambition to gain the party's nomination in the 2006 presidential election, particularly in light of the strong popularity of the PRD's likely candidate, Mexico City Mayor Andres Manuel Lopez Obrador. Lopez Obrador has been an outspoken opponent of Fox's plan. "The rise of Lopez Obrador sent reverberations through the PRI and allowed for the emergence of the neodinosaurs," said Walter Molano, a Latin American analyst at US-based BCP Securities.

At her press conference, Gordillo said she was only relinquishing her post as legislative leader and not her membership in the PRI. Still, some analysts said Gordillo's combative style could also cause her to lose her post as the party's secretary-general. Gordillo pledged to continue to push her policies through the floor debates in the Chamber of Deputies.

One of Gordillo's first actions shortly after her ouster was to formalize a new faction of PRI legislators in the lower house. The faction, Fuerza Reformadora, comprises 60 of Gordillo's PRI supporters in the lower house and could soon be extended to like-minded PRI legislators in the Senate, said PRI Deputy Oscar Pimentel. The new faction has also received a strong endorsement from PRI Govs. Miguel Aleman of Veracruz and Eduardo Bours of Sonora. Aleman went as far as to claim membership in Fuerza Reformadora. "I am a reformer," said Aleman.

Members of the PRI hierarchy said they welcomed the emergence of the new faction as long as it followed the PRI's constitution. "This group will become another of the 45 groupings that already exist within the party structure," said Hector Hugo Olives Ventura, who chairs the internal affairs commission within the PRI's national executive committee (Comite Ejecutivo Nacional, CEN). Olives likened the Fuerza Reformadora to the Grupo Galileo and Grupo Reflexion, which were formed to promote alternative positions within the PRI (see SourceMex, 1999-03-24). "There were not major party splits as the result of these groups," said Olives.

Newly elected legislative leader Chuayffet also issued a statement extending an olive branch to the new faction. "We welcome this new organization as long as its purpose is to propose ideas, strengthen the party, and unify our legislative delegation," said Chuayffet.

But rather than promote party unity, said analysts, the new faction could prove a thorn in the side of the PRI hierarchy in the Chamber of Deputies and at the national level because of the continued feud between Gordillo and Madrazo. "There is a big dispersion and fragmentation of power," political science Jean Francois Prudhomme of Colegio de Mexico said in an interview with the Los Angeles Times. "The PRI has not succeeded in replacing the principle of cohesion or the authority of the republic behind it, which was the main basis of its power."

At least one PRI legislator recommended that disgruntled PRI members leave the party. "[This group] is very risky for the unity of the party," said Deputy Miguel Angel Navarro. "Those who
are not happy would be better off leaving." Guillermo Ortiz reappointed as central-bank head
Opponents of the Fox-Gordillo tax proposal said the defeat of the plan is a rejection of Fox's
economic policies, which they said favor big businesses and foreign companies at the expense of the
poor.

Still, there were mixed signals from PRI legislators on whether they wished to continue to support
Fox's economic plans. While the majority of the party's legislators were defeating the tax plan in
the Chamber of Deputies, the PRI delegation in Senate voted almost unanimously to support the
reappointment of Guillermo Ortiz Martinez as the chief governor of the Banco de Mexico (central
bank).

Ortiz, whose renomination was submitted by Fox, has strongly supported the president's economic
and tax policies, although he has not been shy to also offer criticisms (see SourceMex, 2003-07-02).
Ortiz easily won renomination by an 87-17 margin, with nine abstentions. All except one PRI
senator, along with a handful of PAN members, all five representatives of the Partido Verde
Ecologista Mexicano (PVEM), and two PRD senators, voted in favor of Ortiz. Eight PRD senators and
nine PAN members opposed his nomination.

Another eight PAN members and the lone senator from Partido Convergencia por la Democracia
(PCD) decided to sit out the vote. One of Ortiz's first statements after gaining the renomination
to head the central bank for another six-year term was to support the Fox-Gordillo tax plan. "The
package was not ideal but it was reasonable," Ortiz said in radio interview.

In lieu of an IVA tax increase, Ortiz said it was preferable to maintain the status quo rather than
approve a fiscal plan that would "cause market distortions." He criticized deputies who want to
increase spending next year but voted to oppose an increase in taxes. "Healthy finances are the
backbone of economic stability," Ortiz said on the Radio Formula radio program. "The Banco de
Mexico is not capable of controlling a problem rooted in fiscal policy."

Ortiz's easy ratification was a surprise because of strong criticisms from the PAN to his role in
the controversial bank-rescue program (FOBAPROA) in 1995 (see SourceMex, 1998-11-04 and
2003-11-19). In the end, the PAN split its vote and Ortiz's critics were unable to sway sufficient PRI
members to oppose the renomination. PAN Sen. Hector Osuna, who voted in favor of retaining the
central-bank governor, said the members of the party who voted to ratify the renomination did so in
respect for President Fox.

Most PRD members opposed the renomination because of Ortiz's connection to the neoliberal
policies espoused by Fox's predecessors and continued by the current president. "He represents
the continuity of the economic policies of former Presidents Carlos Salinas de Gortari and Ernesto
Zedillo," said PRD Sen. Raymundo Cardenas, who went as far as to suggest that Ortiz's tenure at
the central bank was imposed on Mexico by the International Monetary Fund (IMF) and the US
Treasury Secretary.

Surprisingly, opposition to Ortiz was not unanimous in the PRD either, with Sens. Demetrio Sodi
de la Tijera and Rodimiro Anaya voting to ratify the chief governor. Sodi, who has tended to vote
independently from his party, noted that Mexico now has the lowest inflation in 30 years and low interest rates, which he credited to Ortiz's policies at the Banco de Mexico. The PRD senator has also broken with his party on the tax issue, opting to endorse a 3% IVA on food and medicines. "It is not right to want our government to spend more [on social programs] while opposing new taxes," said Sodi.

Sodi also criticized alternate revenue plans, which seek to boost government coffers by cutting down on unnecessary expenses. "There are those who say an austerity program could result in savings of 60 billion (US$5.3 billion) or 70 billion pesos (US$6.2 billion), said Sodi. "We won't obtain this amount even if we reduce government salaries and cut down on use of cellular telephones." [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Dec. 17, reported at 11.26 pesos per US$1.00] (Sources: The Dallas Morning News, 12/04/03; Los Angeles Times, 12/08/03; Spanish news service EFE, 12/11/03; Notimex, 12/11/03, 12/12/03, 12/14/03; The Financial Times, 12/09/03, 12/15/03; Agencia de noticias Proceso, 12/03/03, 12/07/03, 12/10/03, 12/11/03, 12/14-16/03; Associated Press, 12/03/03, 12/09/03, 12/16/03; El Sol de Mexico, 12/04/03, 12/09-12/03, 12/15/03, 12/16/03; Unomasuno, 12/05/03, 12/11/03, 12/12/03, 12/15/03, 12/16/03; La Cronica de Hoy, 12/04/03, 12/05/03, 12/08-12/03, 12/15-17/03; Milenio Diario, 12/04/04, 12/05/03, 12/08/04, 12/10/03, 12/12/03, 12/15-17/03; El Financiero, 12/04/03, 12/05/03, 12/08-12/03, 12/15-17/03; El Universal, 12/04/03, 12/05/03, 12/10/03, 12/12/03, 12/15-17/03; The Herald, 12/04, 12/08-12/03, 12/15-17/03; La Jornada, 12/09/03, 12/10/03, 12/12/03, 12/15/03, 12/17/03)