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Budget For Fiscal 2004 Limited by Lack of Tax Reform

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The Mexican Congress waited until almost the last minute to approve a budget for the next fiscal year. The late approval is a major contrast to last year, when legislators approved expenditures and revenues portions of the 2003 budget in a timely manner (see SourceMex, 2002-12-18). The Mexican Constitution requires the Congress to approve a budget for the fiscal year by Dec. 31 of the previous year.

Legislators, who concluded their regularly scheduled session of Congress on Dec. 15, were forced to call a special session to tackle the budget, which was finalized on Dec. 30. The lower house approved the expenditures portion of the 2004 budget at 1.650 trillion pesos (US$151.3 billion). A week earlier, legislators approved the revenues portion of the budget at 1.653 trillion pesos (US$151.5 billion).

In real terms, expenditures for 2004 are only slightly higher than the 1.5 trillion pesos (US$137 billion) approved as part of the 2003 budget. "The 2004 budget is just more of the same," economist Raul Feliz of the Centro de Investigaciones y Docencia Economica (CIDE) told The Dallas Morning News. "It's not a disaster. But it won't solve the [country's] underlying problems."

President Vicente Fox and the Congress had hoped to approve a comprehensive tax-reform plan before the budget deliberations, thus creating the opportunity to boost resources significantly for 2004. Wide disagreements regarding the nature of this tax reform, however, sunk the effort and ultimately contributed to the delay in the 2004 budget deliberations.

Tax reform was a very contentious issue for several months leading to the budget debate. Fox's conservative Partido Accion Nacional (PAN), along with a minority faction of legislators from the former governing Partido Revolucionario Institucional (PRI), was pushing for a fiscal-reform plan that would have imposed a value-added tax (impuesto al valor agregado, IVA) on all goods and services, including previously exempt items like food and medicines.

In contrast, the majority of the PRI, the center-left Partido de la Revolucion Democratica (PRD), and several minor parties opposed an IVA on food and medicines and instead sought to adopt measures like closing loopholes to increase the efficiency of tax collection and simplifying tax laws (see SourceMex, 2003-12-03 and 2003-12-10).

The lack of tax reform means that many items currently subject to the IVA will continue to be levied a rate of 15%, while food, medicines, books, and other items will remain exempt from the tax.

National tax convention proposed
Opponents of the Fox plan said the effort to reform Mexico's tax laws has only been postponed and will be retaken at a future date. PRD legislators said proposals presented at the national tax
convention (Convencion Nacional Hacendaria), planned for February and July, could help form the basis for a tax plan to present to Congress. The convention was first proposed by a governors association (Confederacion Nacional de Gobernadores, CONAGO) in August 2003 (see SourceMex, 2003-08-06).

Still, the failure of Congress and the administration to agree on a tax-reform plan also means that the Mexican government will have to continue to rely on oil exports for about one-third of its revenues. At present, Mexico’s tax collections are the equivalent of only 12% of GDP, one of the lowest rates in Latin America.

A strong global oil market allowed Mexico to maintain expenditures approved under the 2003 budget, even with the country’s sluggish economic performance. Through the first nine months of 2003, PEMEX was reporting pre-tax revenues at 267 billion pesos (US$24.5 billion), an increase of 34% from 2002. The average price of Mexican oil exports for January-September was US$24.73 per barrel. This compares with the average export price of US$20 per barrel that Congress used to determine the 2004 budget.

The expected decline in the average price of Mexican oil exports could limit the state-run oil company's revenues to US$14.3 billion in 2004, compared with the projected US$16.3 billion in 2003. For PEMEX, another byproduct of tax reform would be to give the company a measure of financial independence.

Among the tax-reform proposals floated in Congress for the past several years has been a plan to reduce the tax burden on the state-run oil company, allowing PEMEX to invest a larger share of its revenues on exploration and expansion of infrastructure. This cannot happen, however, as long as PEMEX remains one of the government's principal sources of revenue.

**Analysts predict sluggish economic growth in 2004**

The lack of fiscal reform and the resulting austere budget, meanwhile, has led to forecasts of sluggish economic growth next year. Many private analysts expect the Fox government to have some difficulties meeting its targeted growth level of 3.1% for 2004, with the country's economic fortunes still tied closely to the performance of the US economy.

"While the growth rate of 3.1% is still possible, this will have nothing to do with the budget package approved by the Mexican Congress," said the Confederacion Nacional de Camaras Industriales (CONCANACO). "All in all, this means they are approving a very austere budget," said economist Alfredo Thorne of JP Morgan Chase & Co. in Mexico City. "The consequence is that there will be less potential for economic growth."

Other forecasters like Grupo Financiero BBVA Bancomer and Consultores Internacionales project economic growth at about 2.5% to 2.7%. "This level of GDP growth is not sufficient to allow the industrial sector to emerge from its crisis," said analyst Juan Manuel Gordillo of Consultores Internacionales, who projected a continuation of business failures and layoffs during the coming year.
Still, the Fox administration defends its forecast of 3.1% GDP growth for 2004 despite the lack of tax reform. The growth rate will double the GDP growth of 1.5% projected for 2003, government spokespersons said. They said an improvement in the efficiency of tax collection should provide increased revenues that would help the government boost expenditures for agriculture, poverty reduction, education, and health from last year's levels.

The government may be hard pressed to meet its promises because many of the government ministries that manage social programs suffered budget reductions in 2004. For example, the budget for the Secretaria de Salud (SSA) during 2004 will be 449 million pesos (US$41.1 million) lower than in 2003.

Some private analysts said the uncertainty about expenditures is balanced by the decision of Congress to keep the domestic debt ceiling at 0.3% of GDP, as requested by Fox, which will help maintain economic stability. As part of the budget deal, the finance secretary is allowed to recommend reductions in public expenditures if there appears to be any risk during the year that this target deficit will be exceeded.

"Short term, a silent economic recovery is emerging and is gathering strength," said JP Morgan's Thorne. "The combination of a weak peso, excess capacity, and a booming US economy should keep the economy growing at a 4% pace through the first half of 2004."

Beyond the impact of the US economy on Mexico, analysts are looking at other factors that could affect the country's economic growth, such as interest-rate levels in the US and other industrialized countries, the movement of the Mexican peso in relation to the US dollar, and the direct and indirect impact of Chinese economic policy on the Mexican economy. The Mexican industrial sector remains worried about unfair Chinese competition in the export market (see SourceMex, 2003-09-17 and 2003-10-22).

The Mexico City daily business newspaper El Financiero said other factors related to China could also come into play. "If the Chinese economy overheats, this could affect the global market for raw materials and merchandise," said the newspaper.

**Budget talks marked by political maneuvering**

Political maneuvering was evident during the budget debate, including a successful move by the PRD and the majority of the PRI to prohibit the Fox government from selling off, merging, or shutting down 16 state-owned institutions that had been targeted for cuts.

Among the agencies that the president had included in this list were the government-run news agency Notimex, the salt processor Exportadora de Sal Guerrero Negro (ESSA), the Instituto Mexicano de Cinematografia (IMCINE), and the Churubusco film studio (see SourceMex, 2003-11-19). Some controversy was also evident regarding a plan to impose an additional tax of 20% on cigarettes. The protests against the tax came primarily from legislators representing the tobacco-growing states like Nayarit.
But legislators from other regions, such as PRD Deputy Dolores Padierna of Mexico City, also opposed the tax. "Cigarette buyers already pay sales tax, excise tax, and now they're going to add another 20%," said Padierna, who helped lead a successful effort to repeal the proposed tax. An even more controversial item in the budget talks was a provision to limit the debt ceiling for the Mexico City government to 500 million pesos (US$45.8 million), one-fifth the amount requested by Mexico City's PRD Mayor Andres Manuel Lopez Obrador.

The debt ceiling for the capital is part of the budget criteria because Congress must approve all borrowing by the Mexico City government. Even though Mexico City residents have been given the right to elect their own mayor, some financial decisions such as the debt ceiling remain in the hands of federal authorities.

As expected, Lopez Obrador criticized the decision by Congress to limit his government's ability to obtain loans, which he intended to use primarily for his controversial program to construct a network of double-decker expressways in the Mexican capital. The mayor especially criticized members of the PRI, who had voted with the PRD in opposing Fox's tax reforms but then opposed the center-left party's move to raise the capital city's debt ceiling.

"We knew they were going to do things like this, political measures aimed at 2006, because they don't like us," Lopez Obrador said, referring to PRI legislators. The mayor expressed hope that the Senate could eventually move to increase the debt ceiling, but he also raised the possibility of bringing the issue before Mexico's highest court (Suprema Corte de Justicia de la Nacion, SCJN).

PRI Deputy Carlos Jimenez, meanwhile, defended his party's decision to align itself with the PRD on the debt-ceiling issue. "This alliance wasn't forever," Jimenez said. "We are not necessarily going to always agree." [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Jan. 7, reported at 10.91 pesos per US$1.00] (Sources: Dow Jones news service, 11/17/03; Agencia de noticias Proceso, 12/12/03; Los Angeles Times, 12/24/03; Reuters, 12/30/03; The Herald, 12/15/03, 12/23/03, 12/24/03, 12/30/03, 01/02/04; The Dallas Morning News, 12/30/03; Notimex, 12/03/03, 12/31/03, 01/01/04; Unomasuno, 01/05/04; The Financial Times, 11/10/03, 01/05/04; El Sol de Mexico, 12/15/03, 01/05/04, 01/06/04; La Jornada, 12/08/03, 12/23/03, 12/24/03, 12/26/03, 12/27/03, 12/30/03, 01/02/04, 01/05/04, 01/07/03; Milenio Diario, 12/10/03, 12/24/03, 12/30/03, 01/05/04, 01/07/04; El Universal, 12/23/03, 12/24/03, 12/30/03, 01/02/04, 01/05/04, 01/07/04; La Cronica de Hoy, 12/10/03, 01/05-07/04; El Financiero, 12/15/03, 12/30/03, 12/31/03, 01/05-07/04)