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The initial phase of the tax-reform convention promoted so heavily by President Vicente Fox, the governors association (Confederacion Nacional de Gobernadores, CONAGO), and the various political parties started with a whimper rather than a bang. The entire process of reforming the tax system has been dubbed the Convencion Nacional Hacendaria (CNH). This is only the fourth time in its history, and the first time since 1947, that Mexico has attempted to overhaul its taxation system. Mexico also sought major changes to its fiscal system in 1927 and 1933.

Participants gathered in Queretaro City in central Mexico on Feb. 5-7 to lay the groundwork for discussions on reforms to the tax system. These discussions are scheduled to continue during the next six months, resulting in formal proposals that will be presented to the Mexican Congress in July. To facilitate discussions, participants formed seven working groups to discuss everything from spending, income, and public debt to modernization, intergovernmental coordination, and transparency, among other topics.

"Certainly, we require a legitimate consensus because we are not talking about a simple discussion about certain taxes," said Armando Lara, a columnist for the Mexico City daily newspaper La Jornada. "This is a process where the fiscal structures of the federal, state, and municipal governments are redefined and where the political and economic structures of public spending begin to take a new shape."

Fox urged to abandon plan to expand value-added tax

More than anything, skeptics say, the various participants in the CNH will have to overcome the fundamental difficulties that have driven a wedge between President Vicente Fox's governing center-right Partido Accion Nacional (PAN) and the opposition parties. The PAN, which sees no alternative to expanding the government tax base, continues to support a wider application of the value-added tax (impuesto al valor agregado, IVA). The Fox government has gained support for an expanded IVA among a small faction of the former governing Partido Revolucionario Institucional (PRI), in particular a handful of governors (see SourceMex, 2003-12-17).

The vast majority of PRI members in Congress and the party's leadership have joined the center-left Partido de la Revolucion Democratica (PRD) and other minor parties in opposing Fox's IVA proposal. In the days leading to the start of the convention, legislators from the PRI and PRD reached an agreement to block any efforts by Fox to use the convention to resurrect the IVA proposal, which the Congress voted down in early December (See SourceMex, 2003-12-03).

Still, participants in the three-day session to launch the CNH attempted to put a positive spin on the discussions in the convention. "We come together in a single place, motivated to enter into dialogue,
exchange opinions, and put forth proposals at the three levels of government..." said Fox. "Surely, this process will bring solutions."

PRD leader Leonel Godoy praised Fox for launching the convention with a conciliatory and positive tone. "The president's tone helps toward the goal we all are seeking, that our work is successful," said Godoy. The PRD leader also took the opportunity to warn the president that the party will not accept any solution that is heavily weighted toward a tax increase. "We are in favor of improving the tax-collection system, not of raising taxes."

The PRI leadership committee (comite ejecutivo nacional, CEN) took a harsher tone with the president, criticizing Fox for a "bureaucratic" stance in launching the CNH and for using the opening speech to promote his party's policies. "The president does not understand that structural reforms cannot take root from the political agenda of only one of the parties involved in the dialogue," said Deputy Jose Alberto Auguilar Inarritu, a member of the PRI's CEN. "The agenda has to result from a consensus among all parties."

Still, the PRI executive committee expressed optimism that the convention would succeed in many areas, including a revision of price structures for goods and services regulated by the federal government such as gas and electricity. "The increase in prices for these products has halted our national competitiveness," said the CEN.

Many analysts remain skeptical

Many outsiders viewed the launch of the CNH as merely an opportunity for the political parties to engage in more rhetoric. The Centro de Estudios Economicos del Sector Privado (CEESP) said none of the parties showed any inclination to reach agreement on fundamental changes in the tax system. In a statement, the CEESP said Mexico requires a fiscal system that stimulates the payment of taxes and promotes efficiency in government spending as a means of improving the welfare of society and fostering economic growth. "It is not acceptable that the various groups use their personal interests to halt the changes that will benefit the majority of the population," said CEESP director Mario Rodarte.

Respected economist Rogelio Ramirez de la O, founder of Mexico City-based consulting company Ecanal, suggested the convention may be a waste of time. He said the various concepts that have been discussed thus far lack long-term vision. "It is not clear who is offering what proposals and much less whether the leader or group that introduces a plan has invested sufficient time to develop the proposal and design a strategy," Ramirez de la O said in a column published in the daily newspaper El Universal.

And even with the seemingly diverse number of participants, there were complaints that the convention failed to include a very important group: taxpayers. "They are discussing schemes to collect more taxes, increase the government's monetary reserves, control spending, and prosecute tax evaders," said Adolfo Trevino Garza, president of the Confederacion de Colegios y Asociacion de Abogados de Mexico AC. "But there is not a single working group formed to defend the rights of the taxpayers."
Some business leaders and politicians suggested the Fox government could go a long way toward promoting dialogue by abandoning efforts to include an increase in the IVA in any proposals. "The more this tax is mentioned, the less we have the possibility of reaching an agreement during this electoral year," said Raul Padilla, president of the retail-oriented Confederacion Nacional de Camaras de Comercio (CONCANACO).

Deputy Pablo Gomez, the PRD's leader in the Chamber of Deputies, offered a similar recommendation to the Fox government and PRI proponents of an IVA. "The president's proposal to apply the IVA to food was already rejected in the Chamber of Deputies," said Gomez. "We cannot launch this convention to resurrect a failed proposal because we would then not be working at the level of reality." Still, some business groups are resigned to the probability that reforming the tax system will be a slow process because participants seem to be entrenched in their positions. "They seem to be concerned more with format and not with an in-depth discussion of tax reform," said Alfonso Duenas Blanquel, president of the Mexico City chapter of the Camara de Comercio en Pequeno, Servicios y Turismo (CANACOPE).

**State, municipal governments seek financial independence**

Some leaders and groups used the CNH to unveil specific proposals. Foremost among these was a plan presented by Mexico City Mayor Andres Manuel Lopez Obrador to transfer revenues from states that have the highest rates of tax collection to poor states like Oaxaca, Chiapas, and Guerrero. "The states that have more income and are more developed should help impoverished states," said Lopez Obrador, who is widely expected to be PRD's nominee in the 2006 presidential election.

Lopez Obrador and others also reiterated their intention to ensure that any reforms include a strategy to link local, state, and federal governments in tax-collection efforts. Mexican mayors, represented by the Asociacion de Municipios de Mexico (AMMAC), offered a proposal asking that cities be allowed greater freedom in determining how IVA funds allocated by the federal government are spent. "Our goal is that any IVA collected by cities and states be considered their own revenues," said PAN Mayor Armando Rivera Castillejos of Queretaro City. "Under current practice, we collect the IVA and turn it over to the federal government, which sends it back to us."

Government estimates indicate that taxes collected by municipal governments represent only 0.23% of GDP. Taxes collected at the state level are only slightly higher, 0.4% of GDP. These statistics are put into perspective in a study by the Centro de Investigaciones Estrategicas para Mexico, which notes that the federal government collects 96% of all taxes, compared with 2.4% by state governments and 1% at the municipal level.

The study found that the centralization of tax collection in Mexico is extremely high when compared with other countries. For example, the federal government accounts for about 82% of taxes collected in South Korea, 74% in Spain, 60% in the US, and 49% in Canada. "This is a very worrisome situation because cities and some states are becoming increasingly poorer," said Sen. Sara Isabel Castellanos Cortes of the Partido Verde Ecologista Mexicano (PVEM). "We must make an effort to correct this situation, which has prevailed for decades." In the past two years, federal revenues have been propped up by relatively high global oil markets, which have resulted in increased oil-export earnings for the Mexican government (see SourceMex, 2003-01-22 and 2003-10-15).
The Secretaria de Hacienda y Credito Publico (SHCP) said the increased oil-related earnings allowed the federal government to allocate 30.1 billion pesos (US$2.75 billion) to states in 2003, including for the Programa de Apoyos para el Fortalecimiento de las Entidades Federativas (PAFEF). The SHCP said the funds allocated to states last year were about 96% higher than in 2002. Still, the Fox administration has shown some inclination to help strengthen the ability of state and municipal governments to become financially independent.

The president, however, hinted in a speech that the federal government should continue to have a central role in the country's economic affairs. "No state should become stronger than the federal government," said Fox.

Analysts say this proposed change in the relationship between the federal and state and local governments could be one of the concrete results from the tax convention. "[Any changes] will have to include measures and commitments so that the political cost of collecting taxes is not assumed just by the federal government," said analyst Patricia Calvo, a financial expert on Mexico at Standard & Poor's. Calvo also said any changes would imply that some government functions like education, health care, construction of infrastructure, and other services would no longer be primarily the domain of the federal government but also of the city and state governments.

[Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Feb. 11, reported at 10.97 pesos per US$1.00] (Sources: The Herald-Mexico City, 02/05/04, 02/06/04; Notimex, 02/04-08/04; El Financiero, 02/05/04, 02/09/04; Milenio Diario, 02/06/04, 02/09/04; Agencia de noticias Proceso, 02/04-06/04, 02/10/04; El Sol de Mexico, 02/05/04, 02/06/04, 02/09/04, 02/10/04; La Jornada, 02/05-10/04; La Cronica de Hoy, 02/05/04, 02/08-10/04; Unomasuno, 02/05/04, 02/06/04, 02/09/04, 02/10/04; El Universal, 02/05-07/04, 02/09-11/04

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