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The tax-reform proposal approved by Congress in mid-September is expected to increase government expenditures on infrastructure, health, and education, which could translate into a higher growth rate than President Felipe Calderon anticipated in the budget proposal he sent to Congress in early September.

The Chamber of Deputies and the Senate approved the changes to the tax code a little more than a week after the Secretaria de Hacienda y Credito Publico (SHCP) sent its budget plan to legislators. The tax plan is expected to boost government revenues by about 115 billion pesos (US$10.5 billion) in 2008, the first year in which the changes would be in effect (see SourceMex, 2007-09-19).

By law, the Congress must approve the budget, in two separate steps, by a Nov. 15 deadline. The first step involves the income portion of the budget (Ley de Ingresos), and the second step deals with expenditures (Presupuesto de Egresos). In both cases, legislators will be working with proposals presented by the Calderon administration.

The proposal the administration submitted to Congress did not incorporate the tax changes. But even without tax reform, the administration was projecting income from the value-added tax (Impuesto al Valor Agregado, IVA), the income tax (Impuesto Sobre la Renta, ISR), and other taxes to increase by 8% in 2008.

Additionally, the proposed budget contained higher expenditures than the Calderon government originally envisioned. The administration proposed expenditures of 2.39 trillion pesos (US$218 billion). Just days before the budget was submitted, the administration was contemplating two proposals. One included expenditures of 2.26 trillion pesos (US$206 billion) without tax reform, and the other contained 2.49 trillion pesos (US$228 billion) with the tax changes.

Budget anticipates only 3% GDP growth; revision possible

The SHCP said the 2.39-trillion-peso (US$215 billion) spending plan is up 3.3% in real terms from the budget approved for 2007 (see SourceMex, 2006-12-13 and 2007-01-03). As part of the budget proposal, the SHCP projected GDP growth in 2008 at only 3%, compared with 3.3% in 2007. The forecast for reduced growth was linked to projections of a sluggish US economy, which is the largest market for Mexico's exports.

With the tax reforms and increased expenditures, however, Mexico's GDP could grow as much as 3.7% next year, some analysts said. The SHCP budget plan also assumes an average oil-export price of US$46.60 per barrel in 2008, higher than the US$42.80 used to determine the 2007 budget. That SHCP estimate is probably understated, barring a sudden collapse in the global oil market.

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The export price for all three grades of Mexican crude oil averaged US$54.20 in the first seven months of 2007, according to statistics released by the state-run oil company PEMEX. The company expects to export an average of 1.68 million barrels per day in 2008.

In the near term, Mexico's budgets will have to take into account a new reality: the continued decline in Mexico's oil reserves (see SourceMex, 2006-03-22 and 2007-03-07). The Congress considered this when crafting the tax-reform proposal approved this year. This factor was also reflected in the budget proposed by Calderon, which anticipated a decline in crude-oil production in 2008 to 3.14 million barrels per day, compared with 3.26 million bpd in 2006. Daily production for 2007 was estimated at about 3.16 million bpd.

Before the tax-reform bill was enacted, the administration was wrestling with expanding limits on social spending or infrastructure. The budget plan opted for social programs. "If we had a tax-reform in place [at the time that the budget was submitted], we would have increased the amount of money allocated for highway construction," said deputy finance secretary Ernesto Cordero. "This would have given us a chance to promote employment.

In its budget outline, the SHCP emphasized that its proposal projected a balanced budget, but warned of a possible public deficit in 2008 as a result of comprehensive reforms to the health and pension system for government workers (Instituto de Seguridad Social al Servicio de los Trabajadores del Estado, ISSSTE) approved in March (see SourceMex, 2007-03-28). In the short term, transition costs of the ISSSTE reform will outweigh immediate savings, although savings in the medium term will change that situation.

The actual cost of the transition will depend on how many workers choose to switch to individual accounts from the existing defined-benefits system, the SHCP said. Opposition parties to perform "surgery" on budget plan Legislators from the opposition Partido de la Revolucion Democratica (PRD) and Partido Revolucionario Institucional (PRI) have already served notice to the Calderon administration that they will "perform surgery" on the plan presented by the executive branch.

The opposition legislators in the lower house have pledged to boost social spending beyond what the administration has proposed. Legislators also promised to impose austerity measures on the expenditures by the executive branch. "If we see that the administration is proposing unreasonably high expenditures [for its bureaucracy], we will cut them, just as the Congress has done with previous budgets," said Deputy Emilio Gamboa Patron, PRI floor coordinator. "If we determine that the allocations for education and social spending are not compatible with our proposals, then we will increase these line items."

"[The administration] claimed it needed tax reform to boost expenditures for social programs, yet it was proposing a 9.3% increase for the Presidency," said PRD floor leader Javier Gonzalez Garza.

Farm groups push for higher spending on agriculture

The Calderon budget, submitted before the tax-reform was approved, proposed higher spending for national defense and public safety and for tourism. Modest increases were also proposed for some

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social programs, such as health and social security. But expenditures for higher education would only increase by 1.3%, while those for agriculture would actually be reduced by almost 11%.

The administration's budget proposed reductions for the Secretaria de Agricultura, Ganaderia, Desarrollo Rural, Pesca, y Alimentacion (SAGARPA) and for the Secretaria de Reforma Agraria (SRA). The proposed reduction in agriculture expenditures angered some groups that represent producers and rural interests, which raised concerns that the lack of government supports would leave Mexican farmers even more vulnerable to foreign competition, particularly with the pending elimination of import tariffs on corn, beans, sugar, and powdered milk on Jan. 1, 2008 (see SourceMex, 2006-09-06).

The Central Campesina Independiente (CCI) criticized Calderon for proposing to eliminate 14 important programs -including rural electrification, support for purchasing fertilizers, and export assistance from SAGARPA and SRA to save about 11.6 billion pesos (US$1.1 billion). "The loss of the programs would affect the lowest-income producers," said CCI secretary-general Rafael Galindo Jaime.

The Confederacion Nacional Campesina (CNC) has also expressed its displeasure about the budget and is planning to picket the San Lazaro congressional building during the budget deliberations to convince the Chamber of Deputies to increase expenditures for agriculture. In particular, the CNC is pushing for the Congress to restore the Programa de Competitividad de las Ramas de Produccion, which offered direct subsidies to agriculture producers.

The CNC is also pushing for the Congress to create a special economic-development and employment program in some of the poorest rural communities in Mexico, which have lost many residents to emigration to the US. CNC president Cruz Lopez said these communities might suffer the effects of a US crackdown on employers who hire undocumented workers (see SourceMex, 2007-05-23), which would reduce the amount of money sent back to Mexico via remittances. This trend was already evident in the early part of 2007, with slower growth in remittances than in previous years (see SourceMex, 2007-08-15).

Some legislators are also seeking to use the budget process to limit the huge pensions that former presidents receive. The pensions, higher than those received by US counterparts, are not included as a specific line item but are disbursed through a special discretionary fund allotted to the sitting president. Each of the living former presidents Luis Echeverria Alvarez (1970-1976), Miguel de la Madrid (1982-1988), Carlos Salinas de Gortari (1988-1994), Ernesto Zedillo (1994-2000), and Vicente Fox (2000-2006) is entitled to almost 52 million pesos (US$4.8 million) per year. Only Zedillo has declined the pension, saying he does not need the money. Zedillo earns hefty fees as a consultant to several multinational companies.

PRD Sen. David Jimenez has proposed an initiative to sharply reduce the amount of money given to the ex-presidents by regulating the president's discretionary authority to make these payments. "We are talking about an illegal payment," said Jimenez. "This is not a pension or a retirement fund, which is disbursed only after an employee has worked 30 years, as required by law." Jimenez's proposal is the latest effort to regulate presidential pensions.

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In 2002, Congress proposed a measure to cut back on the payments (see SourceMex, 2002-06-12), but the initiative was never approved. The issue is separate from but related to charges that Fox used his term in office to increase his wealth. The accusations followed a magazine article, which showed photographs of the ex-president's ranch before he became president and after he left office. The post-presidency pictures showed evidence that Fox carried out a costly remodeling of his ranch (see other article in this issue of SourceMex). [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Sept. 26, reported at 10.92 pesos per US$1.00.]

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