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The government’s decision to postpone implementation of a new tax on gasoline until the beginning of 2008 helped keep Mexico’s annual inflation rate at 3.76% for 2007. While the figure was among the lowest in more than three decades, the price of goods and services will almost certainly go up in 2008 because the gasoline tax is now in place. Critics say the resulting increase in the cost for basic foodstuffs will disproportionately affect the poor. Other factors will also contribute to higher annual inflation during the year, including the already high cost of energy and the new tax imposed on businesses (Impuesto Empresarial a Tasa Unica, IETU) as part of the tax reform approved by Congress in 2007. Many businesses warn that the combination of the gas tax and IETU will limit GDP growth in 2008.

Delay helps Mexico attain low inflation rate in 2007

The controversial gas tax, which Congress approved in September 2007 as part of the comprehensive tax-reform package, was scheduled to go into effect during the last quarter of 2007 (SourceMex, September 19, 2007). The tax, known in Mexico as the gasolinazo, unleashed a wave of speculation in October that caused consumer prices to rise faster than anticipated. This prompted President Felipe Calderon to freeze energy prices, including postponing the gas tax until the start of 2008 (SourceMex, October 03, 2007).

Under a timetable established by the federal government, the tax will now be implemented gradually between January 2008 and June 2009. The president's move succeeded in curbing inflation during the fourth quarter of the year, keeping annual inflation in 2007 to 3.76%, the second-lowest rate since the Banco de Mexico (central bank) started to monitor annual inflation in 1973. The lowest rate in the last 34 years came in 2005, when Mexico registered annual inflation of 3.3%. Because of increases in global food prices and fuel, some analysts had projected that Mexico's annual inflation rate would surpass 4% in 2007.

Many private analysts and business organizations say the gas tax is sure to create inflationary pressures, especially in the first part of the year. "There will be an inflationary bubble in the first quarter of the year, because of increases in gasoline, diesel, public fees, electricity, gas, salaries, cement, steel and its byproducts," said the Confederacion Nacional de Camaras Industriales (CONCAMIN). The financial services company Invex Grupo Financiero is projecting the accumulated inflation rate for January-June at 4.5%, which matches forecasts issued by the Banco de Mexico for the same period (SourceMex, November 07, 2007). But private and government analysts generally agree that inflationary pressures will start to ease in the second half of the year, with some predictions putting annual inflation at about 4% for 2008. This is still higher than the 3% projected by the Secretaria de Hacienda y Credito Publico (SHCP) as part of the 2008 budget proposal sent to Congress in September 2007.
Concerns about increase in food prices

The increase in fuel prices is expected to produce a chain reaction in the Mexican economy, with many industries threatening to raise prices to compensate for the higher transportation costs. The government is worried that some of these increases will be disproportional to the increase in fuel costs. For example, Lorenzo Mejia, president of the Union Nacional de Industriales de Molinos y Tortillerias (UNIMTAC), had warned that prices for tortillas could rise to about 15 pesos (US$1.37) per kg. This would be almost twice the price of 8.50 pesos (US$0.77) set under an agreement between the government and the private sector (SourceMex, April 18, 2007). The government sought the agreement after corn prices surged in 2006 and 2007 as a result of the increased demand in the US market (SourceMex, January 10, 2007, January 31, 2007 and September 05, 2007).

The Secretaria de Economia (SE) said projections by Mejia and UNIMTAC were off base because Mexico currently has a surplus of white corn, the primary ingredient used to produce cornmeal and tortillas. "We have different conditions than we had in 2007," said the SE. Economy Secretary Eduardo Sojo acknowledged that prices could be up during January, but said it was not because of the increase in the price of gasoline. "This January is no different from other Januaries," said the economy secretary, who noted that prices tend to fluctuate during the month. Some increases in the price of tortillas were reported in the early part of January in states like Veracruz, Oaxaca, Guerrero, and Tamaulipas because of the slight rise in transportation costs. In some areas of those states tortillas were selling at 10 pesos (US$0.91) per kg.

The tortilla industry is not in agreement about the potential for prices to increase steeply. Arturo Lopez, director of the Camara de la Industria de la Masa y la Tortilla (CNIMPT), said he does not believe the conditions exist for prices to reach 15 pesos. "These rumors have to stop because they will generate economic instability," said Lopez. Guillermo Campos Coy, a member of the Consejo Promotor y Regulador de la Cadena Maiz-Tortilla, called on the government to provide financial and regulatory assistance to the industry to keep prices below the ceiling of 8.50 pesos. "The government has to assume its responsibility in strategic areas, including constructing facilities for growers to sell and store their corn," said Santos Coy. "There is also a need to reduce the costs of road and railroad transportation to compensate for the increase in the price of fuel." Center-left opposition, unions organize protests Although many tortilla-industry officials disputed the UNIMTAC forecast, the possibility of high tortilla prices raised strong concerns among politicians and labor leaders.

Federal Deputy Luis Sanchez Jimenez warned that an increase in food prices could lead to social discontent in Mexico. An increase in tortilla prices to 15 pesos per kg "would be the last straw" for many poor families in Mexico, said Sanchez Jimenez, a member of the center-left Partido de la Revolucion Democratica (PRD). Legislators from the Convencion Nacional Democratica (CNV) coalition, which supported the candidacy of Andres Manuel Lopez Obrador in the 2006 presidential election, are planning to organize a series of demonstrations to protest the gasoline tax and the elimination of tariffs for corn, beans, rice, and powdered milk under the North American Free Trade Agreement (NAFTA). The CNV includes legislators from the PRD, the Partido del Trabajo (PT), and the Partido Convergencia por la Democracia (PCD). Under NAFTA, tariffs on imports of those products from the US and Canada were eliminated, effective Jan. 1, 2008. There is a strong push for the government to renegotiate the agriculture sector of NAFTA to allow tariffs to be reinstated. The
strong demand for corn in the US makes it unlikely that the Mexican market will be flooded with US corn in the near term (SourceMex, December 12, 2007).

The potential for increases in food prices also prompted the two principal labor organizations affiliated with the other major opposition party, the Partido Revolucionario Institucional (PRI), to organize a campaign to prevent an increase in the cost of basic goods. The Congreso del Trabajo (CT) and the Confederacion Revolucionaria de Obreros y Campesinos (CROC) called on their members to oppose any unjustified increases in the cost of basic products. "There is no reason why there should be any speculation in the price of tortillas, and there is no justification for an increase in the price index for the basic basket of consumer goods," the two organizations said in a joint statement.

Responding to the concerns about possible price-gouging, the federal consumer protection agency (Procuraduria Federal del Consumidor, PROFECO) said it would keep a close eye on retailers and wholesalers to prevent "practices that are harmful to the consumer." Some private organizations like the Centro de Estudios Economicos del Sector Privado (CEESP) agreed that factors other than the gas tax were driving up basic consumer prices. "The increases are not justified and are responding primarily to speculative factors," the CEESP said in a report published in early January.

The CEESP pointed out that, despite the inflationary pressures faced by the Mexican economy in 2007, annual inflation ended the year within the range established by the Banco de Mexico. "It is now clear that the increase in the price of gasoline will have a minimal effect on inflation," said the CEESP, which also noted that the government has taken steps to reduce the influence of external factors. Mexico's largest association of retailers, the Asociacion Nacional de Tiendas de Autoservicio y Departamentales (ANTAD), also took action in the wake of the implementation of the gas tax.

In mid-January, the organization announced that its members would reduce the prices of more than 300 basic products. ANTAD president Vicente Yanez said the organization wanted to do its part to offset the perception that the gas tax would create uncontrolled inflation. While the government and consumers welcomed ANTAD's gesture, some analysts pointed to the continuing structural problem in the Mexican economy: wages are not keeping up with inflation. "The question that we as Mexicans have to ask ourselves is whether we have the ability to buy the same amount of goods that we did a month ago, three months ago, or a year ago," said Eduardo Carbajal, chair of the finance and economy department at the Tecnologico de Monterrey, Mexico state campus. "An increase in purchasing power has been an unattainable goal historically," added Carbajal, in a column published in the Mexico City daily business newspaper El Economista. "Prices have been increasing more than earnings, which in real terms has reduced the amount of goods and services that an individual can acquire each year." Higher taxes could also limit GDP growth in 2008 Business organizations like CONCAMIN reluctantly accepted the gas tax and the IETU.

These organizations, however, are warning that the new taxes could reduce Mexico's GDP growth in 2008. "We have started 2008 under a dark cloud," CONCAMIN said in an internal report, noting a drop in production in the textile, clothing, and footwear industries. "The Mexican economy remains very fragile." Finance Secretary Agustin Carstens acknowledged that the government would have to reduce its projections for GDP growth in 2008 to about 3.3% from earlier estimates of 3.7%, in part
because of an expected slump in the US, which accounts for about 80% of Mexico's exports. "The markets have adjusted their projections significantly," said Carstens. "This perspective appears reasonable." The reduced projections for 2008 would match the actual GDP growth in 2007, which is estimated at about 3.1%. And some private-sector forecasts suggest that Mexico's GDP growth in 2008 could slump below 3%.

In projections released in mid-January, the Instituto Mexicano de Ejecutivos de Finanzas (IMEF) and financial-services company Coface put Mexico's economic growth for this year at 2.8%. Among other things, a US slump could also reduce the remittances sent by expatriates to Mexico, particularly if the slowdown has a major impact on such US industries as construction, tourism, and food service, the source of employment for many Mexicans. Remittances, which have grown at a steady pace in recent years, could stagnate or even decline slightly in 2008. Preliminary government statistics indicate that remittances in 2007 were basically unchanged from 2006, at about US$23.7 billion (SourceMex, April 11, 2007 and August 15, 2007).

Despite the US slump, the Banco de Mexico believes that strong economic indicators, including a relatively high level of reserves, will keep the Mexican economy afloat in the face of a US slowdown. "We can expect that the Mexican economy is going to be able to resist fairly well this period of slowdown in the United States," said Central Bank Governor Guillermo Ortiz Martinez. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Jan. 16, reported at 10.93 pesos per US$1.00]