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President Felipe Calderon's 2010 budget proposal avoided the contentious value-added tax (impuesto al valor agregado, IVA) on food and medicines, but the president stirred up a hornet's nest by proposing a different tax, which would be levied on consumption of almost all goods and services. Although the proposed tax would increase funds for social programs, critics charged that the levy would hurt the poor disproportionately, in what amounts to "taxing the poor to help the poor." Others were just as adamant about the tax's negative impact on the middle class. Even the business sector, which recently came out in support of a modest IVA on food and medicines, criticized Calderon's tax plan as counterproductive, particularly because the president also proposed several other tax increases.

Tax intended to raise funds for anti-poverty programs

The president's revenues budget (Presupuesto de Ingresos), which Finance Secretary Agustin Carstens presented to Congress in early September, contained the controversial tax, denominated the Contribution to Combat Poverty (Contribucion para el Combate a la Pobreza), which would levy a 2% consumption tax on the entire production chain. Carstens estimated that the tax would increase revenues by about 70 billion pesos (US$5.3 billion), money that would fund programs that help the 14 million people who live in poverty in Mexico.

Administration officials envision an increase of 50% in funding for Oportunidades and other public-assistance programs. "Mexican families are the priority of the administration," said Social Development Secretary Ernesto Cordero Arroyo. The tax faces an uphill battle in Congress, which must approve the revenues budget before considering the expenditures budget (Presupuesto de Egresos). Some members of the opposition parties have soundly criticized the proposed 2% levy as an "IVA in disguise" and a new tax on the poor. "This tax isn't going to pass because it's a disguised IVA for food and medicine," said Deputy Silvano Aureoles Conejo, deputy floor leader for the center-left Partido de la Revolucion Democratica (PRD).

Deputy Jesus Alberto Cano Velez, who coordinates a group of economic experts for the Partido Revolucionario Institucional (PRI), used the same term. "This is just like a disguised IVA because it involves a tax on consumption," said Cano Velez. "The only difference is that the money has been designated for a set purpose." Other legislators also weighed in, with several members of the PRI delegation noting that their party's platform prohibits new taxes and any actions that would increase the cost of basic products. "In principle, the party's position is that, in time of crisis, when people do not even have enough to eat, raising taxes is not the best measure," said Deputy Jorge Herrera, a member of the PRI's economic team in the lower house.

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Deputies Armando Rios of the PRD and Porfirio Munoz Ledo of the Partido del Trabajo (PT) questioned the impact of the budget on the poor. "It does not make sense for the president to propose a 2% tax on consumption to combat poverty," said Munoz Ledo. "This tax will disproportionately hurt the poor." The issue also made the rounds in the Mexican media. Syndicated columnist Miguel Angel Granados Chapa pointed out that several items that were previously exempt from tax such as food, medicines, and books would be subject to the levy under Calderon's plan. "This could be the first step in adding those products to the fiscal regimen of value-added items, which are susceptible to annual increases," said the columnist.

Granados Chapa also warned about the tax's inflationary effect. "Supporters might say that consumers might be able to afford the 2% rate," said the columnist. "But there is a real threat that it could cause a generalized increase in prices." Credible institutions like the Banco de Mexico (central bank) have also warned the administration against increasing taxes during economic hard times. Carstens acknowledged that the tax increases would boost inflation but said the increase would be below one percentage point.

President proposes other controversial tax increases

The private sector is also worried about the inflationary aspect of the 2% tax, but there is even greater concern about Calderon's plan to increase a host of other taxes, including on gasoline, diesel, heating oil, and electricity, and a new surcharge on telecommunications usage. In addition, there is a proposal to increase the corporate tax (Impuesto Empresarial a la Tasa Unica, IETU), the income tax (Impuesto sobre la Renta, ISR), and the bank-deposits tax (Impuesto a los Depositos en Efectivo, IDE). In comments to reporters following the budget presentation to Congress, Carstens offered reassurances that some of the increases would be temporary and that some taxes, in particular the ISR, would be rolled back to 2009 levels by 2012.

Calderon's proposal to increase taxes comes at a time when government revenues are down sharply. The administration has also proposed reducing expenditures by cutting the size of government, including eliminating three Cabinet ministries and moving their functions to other entities (SourceMex, September 09, 2009). While the consumption tax is likely to create increased burdens for low-income families in Mexico, many economists say that the tax, along with all the other taxes proposed by the Calderon government, will especially hammer the middle class, the demographic that most commonly meets its tax obligations.

Some analysts pointed out that the middle class is also the group in Mexico that consumes, invests, and saves the most. Concerns were also raised about the ISR increase, which some analysts said would inhibit investment and job creation when the Mexican economy needs to grow, not contract. The ISR increase "taxes productivity," said Salomon Presburger, president of the Confederacion de Camaras Industriales (CONCAMIN). But Presburger supported the proposed 2% consumption tax. The private sector raised other concerns. For example, Armando Paredes of the Consejo Coordinador Empresarial (CCE) said that Calderon's budget goes against the president's promise to simplify the tax system. "[The plan] also fails to stimulate investment and promote growth opportunities for companies," said Paredes. Ricardo Gonzalez Sada, president of the Confederacion

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Patronal de la Republica Mexicana (COPARMEX), complained that the president's plan does not lead to a reduction in government spending, even with plans to cut the size of government.

In particular, Gonzalez Sada noted that the budget maintains privileges for many high-level bureaucrats. Another area that might cause some disagreement with the opposition parties is the administration's decision to maintain certain expenditures for the executive branch at a fairly high level. "Despite the government's announcement that it would take certain austerity measures, the presidency is planning to spend about 1.72 billion pesos (US$130 million)," said the Mexico City daily newspaper La Jornada, which noted that a share of that money would be devoted to maintenance of airplanes and salaries of pilots. "The administration justifies these expenditures as necessary for security and to guarantee that the president has all the means necessary to adequately perform his duties." Supporters say tax increases are preferable to debt Amid all the criticisms about the proposed taxes, Calderon found strong support among members of his Partido Accion Nacional (PAN).

In comments to reporters, PAN president Cesar Nava denied that the 2% tax would hurt the middle class. "The new tax that has been proposed would not hurt the middle class significantly," said Nava. Several PAN legislators suggested that the tax is preferable to borrowing heavily, which would plunge Mexico further into debt and hurt the economy in the long run. Financial rating agencies agreed that the budget plan at first glance is positive for Mexico's standing in international debt markets. Shelly Shetty, an analyst at Fitch Ratings, said her company views the government's efforts to prevent a "significant deterioration" of the country's fiscal accounts as a positive step. "Fitch will assess the implications of the recent fiscal measures proposed," said Shetty. Others agreed. "The government is pointing in the right direction," said Enrique Alvarez, head of Latin America fixed-income research at IDEAglobal Inc. in New York. "You see some stern stances for the need to increase revenue. The bottleneck comes now with the political negotiations, where it's very likely that we'll have a watered-down reform."

Calderon and the PAN are very aware that the PRI will have a strong influence on the final version of the 2010 budget. The PRI and its coalition partner, the Partido Verde Ecologista Mexicano (PVEM), control 258 of the 500 seats in the Chamber of Deputies. And, in many budget matters, the position of the three center-left parties, which control 90 seats, is likely to coincide with the PRI and PVEM. The PRI has given mixed signals on its intentions. Party leaders have made it plain that the party will use its new muscle to influence the budget process. "We will demand that our positions be taken into account during the discussions," said Deputy Oscar Levin Coppel, who is close to party president Beatriz Paredes. "We are going to make our majority count." But several key PRI members in the lower house offered a more conciliatory approach.

Deputy David Penchyna said in an interview with Radio Formula that his party sees room to negotiate Calderon's proposed budget. Deputy Cesar Santiago made similar comments in a television interview. "We and a lot of lawmakers from all the parties are concerned about doing good and not causing harm or setting people back," he said. Budget assumes 3% growth in 2010 Calderon has proposed a budget of about 3.172 trillion pesos (US$240 billion), which in real terms is about 0.6% below the budget that Congress approved for 2009 (SourceMex, November 19, 2008).

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The president's budget also assumes a deficit of 2.5% of GDP, including debt investments by the state-run oil company PEMEX. This would compare with 2.1% of GDP in 2009. Not including the PEMEX debt, the Calderon plan calls for a budget deficit of 60 billion pesos (US$4.5 billion) in 2010, equivalent to 0.5% of GDP. The plan envisions reducing that deficit to 40 billion pesos (US$3 billion) in 2011. Some PRI legislators suggested that they might consider a higher debt in the final budget. The Calderon blueprint also assumes a GDP growth of 3% for 2010, similar to the growth rate the administration estimated in the 2009 budget submitted to Congress. A congressional committee later cut the 2009 forecast to 1.8% of GDP growth (SourceMex, October 15, 2008).

Both the Calderon and congressional estimates did not anticipate the impact of a US economic downturn on the Mexican economy, with a major contraction, rather than growth, anticipated. Most forecasts now project Mexico's GDP to contract by 6% or 7% in 2009 (SourceMex, July 15, 2009 and September 02, 2009). The Secretaria de Hacienda y Credito Publico (SHCP) said the growth forecast of 3% for 2010 would be a reversal of this year's negative growth but would fall far below the long-term potential for the Mexican economy. Another important factor that the administration and Mexican legislators take into account in the budget is the projection for Mexico's average oil-export price in 2010.

The administration has projected a price of US$53.90 per barrel, far below the price of US$80 per barrel that the Calderon government had projected in its 2009 budget and the US$70 per barrel projection ultimately approved by Congress. Levin Coppel said that the PRI might seek a higher forecast for the average oil-export price but did not specify an actual level. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Sept. 16, 2009, reported at 13.18 pesos per US$1.00]

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