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Congress Approves Revenues Budget That Includes Controversial Tax Increases

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During the last weekend of October, the Congress ratified a controversial plan to raise consumption and income taxes and impose levies on services such as telecommunications and bank deposits. The new taxes, included in the revenues portion of the 2010 budget (Ley Federal de Ingresos), are part of an effort by the legislature to provide more money for the federal government, which is facing a deficit caused by a decline in oil-export revenues and a slowdown in the global economy. However, the discussions regarding revenues opened wounds that could take some time to heal. The process disrupted party unity in the governing Partido Accion Nacional (PAN) and in the opposition Partido Revolucionario Institucional (PRI), strained relations between President Felipe Calderon's administration and the business sector, and put those business organizations on the same side as the center-left coalition, led by the Partido de la Revolucion Democratica (PRD).

The revenues debate began with the budget plan that Calderon sent to Congress in September. In it, the president offered a generalized 2% tax on consumption of all goods and services (SourceMex, September 16, 2009). Proceeds from the tax, which would have raised an estimated 70 billion pesos (US$5.2 billion), were to be used to fund social programs. All opposition parties immediately rejected this proposal, saying it would disproportionately hurt lower-income Mexicans. PRI seeks to pass political cost to governing PAN While the opposition parties made a lot of noise about not wanting to raise taxes, the PRI eventually became more pragmatic during discussions on a compromise plan in the Chamber of Deputies, the first of the two legislative bodies to debate budget proposals.

The PRI and its coalition ally the Partido Verde Ecologista Mexicano (PVEM), which hold a plurality in the lower house, joined members of the PAN on Oct. 21 to craft a budget that raised the value-added tax (impuesto al valor agregado, IVA) by one percentage point to 16% and the Impuesto sobre la Renta (ISR), a type of income tax, by two percentage points to 30%. Taxes were also added on certain goods and services, such as cigarettes, beer, and telecommunications.

The Chamber of Deputies also lowered the ceiling on bank deposits subject to taxation from 25,000 pesos (US$1.190) to 15,000 pesos (US$1,130). Those deposits would be charged a 2% tax, compared with 3% requested by the Calderon administration. The Chamber of Deputies approved the revenues budget by an overwhelming 415-24 margin, with 10 abstentions. The taxes are expected to give the federal government an additional 116 billion pesos (US$8.7 billion) in revenues for 2010. Although the measure won easy approval in the lower house, there was a lot of discussion on which party was willing to assume the political costs of raising taxes.

PRI legislators issued several statements suggesting that the party's support for higher taxes was reluctant. By supporting the plan, they said, they avoided other proposals that sought to directly

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impose an IVA on food and medicines. Additionally, they insisted that the move to raise taxes was a request from the Calderon administration. The dispute on ownership of the tax increases was even more dramatic in the Senate, where the PAN has a plurality. The drama unfolded during the last weekend of October, with the Senate facing a legal deadline to approve the measure sent over from the Chamber of Deputies. During the vote on the bill, most of the PRI delegation decided either to be absent or to abstain from the vote, leaving the PAN to cast the only votes in favor of the revenues budget and the tax increases. As a result, the measure passed by a 53-28 margin, with all negative votes cast by the center-left parties. The maneuver angered PAN senators, who accused the PRI of selling out because they had supported the revenues budget and the tax increases when they were discussed in committee. "I have no respect for them," PAN Sen. Beatriz Zavala said of her PRI colleagues. "They wanted to appease PRI governors who were clamoring for more money, but they also did not want to assume the political costs. So they took the coward's way out in the budget vote."

A group of PAN senators, led by Sen. Santiago Creel, had threatened to vote against the tax increases if the PRI refused to share the political cost of the decision. In the end, the PAN delegation supported the measure because of strong pressure from the Calderon administration. PRI legislators in both houses said they supported the tax increases reluctantly, acknowledging that the government would face a severe crisis if revenues were not increased, given the decline in oil-exports earnings. "We voted in the best interests of Mexico," said Deputy Francisco Rojas Gutierrez, floor leader for the PRI in the lower house. "We are all aware that growth will not be sufficient and that the basic obligations of the state could be at risk if we do not give the government the tools to obtain the needed revenues." But Rojas also took potshots at the administration, citing "deficiencies in its economic model and inadequacies of the federal government." PAN legislators took the position that there was no other option but to increase taxes, given the rapidly declining oil-export revenues. "Mexico cannot continue to live from oil," said Deputy Luis Enrique Mercado. "Oil is a resource that is disappearing, and we have to replace this income from other sources."

To back this argument, the Secretaria de Hacienda y Credito Publico (SHCP) issued statistics in late October indicating that public-sector earnings were down 8.7% in real terms during the first nine months of this year relative to January-September 2008. The SHCP said oil-export revenues were down about 24.4% during the period, while taxes from non-oil sources declined by about 13%. Internet groups convince Congress to eliminate online-services tax The disputes among the three political groupings the PAN, the PRI-PVEM, and the center-left coalition masked disagreements within the parties and between the political establishment and various interest groups outside party politics.

A fissure appeared between the PRI members in Congress and several PRI governors who were solidly behind the Calderon plan to raise taxes. In the PAN, senators resented the heavy pressure from the Calderon government to move forward on the tax increases. But PAN legislators from both chambers resented the administration for not including them in negotiations that led to the compromise plan that included the increases in the IVA, ISR, and other taxes. Calderon conducted these talks entirely with PRI legislative leaders. Friction also developed between the government and several interests affected by the tax increases. For example, the original scheme to tax telecommunications services proposed in the Chamber of Deputies contained a tax on

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Internet activity. This led organizations such as the Asociacion Mexicana de Internet (AMIPCI), the Asociacion Nacional de Telecomuncaciones (ANATEL), and InternetNecesario to mobilize members to pressure the Senate to remove the tax from the bill.

Many Internet users lobbied the Congress using the Twitter network, leading some media outlets to write headlines that said, "Twitteros mobilize." Still, users of the Internet and other telecommunications services argued that access to online services was essential to help Mexico's economic growth. "Telecommunications are not a luxury," said ANATEL spokesperson Eunice Hernandez Ochoa. "There are currently more than 80 million users of these services, who reduce their use if the cost increases. This would affect the development of the industry in Mexico. The telephone and the Internet are a business tool and a powerful engine for development." Others pointed out that not only the wealthy use online services. "Let us remember that 44% of those who use the Internet belong to groups whose earnings are less than 11,600 pesos (US$872) per month," said AMIPCI president Julio Cesar Vega.

Vega and other experts also pointed out that Mexico ranks last among the 30 members of the Organization for Economic Cooperation and Development (OECD) in Internet connectivity. They argued that an Internet tax would be counterproductive to efforts to improve that ranking. Because of the pressure from Internet-user groups, the Senate removed the Internet tax from the bill but left in some taxes for other telecommunications services. The Chamber of Deputies accepted these changes when it received the Senate version of the bill on Nov. 1.

Calderon battles with business groups on tax payments

The biggest public confrontations regarding the tax proposals involved the Calderon administration and the PAN's traditional ally, the business sector. During various speeches around the country, the president sharply criticized businesses for pressuring the government to impose an IVA on food and medicines while not paying their fair share of taxes. "What I find most unacceptable is for the big conglomerates to demand that the government cut its expenditures and then ask for a tax to be imposed on food and medicines, hurting those who can least afford it," the president said in a speech before members of the chemical industry. "I am not asking companies in Mexico to pay more than what a dentist, an employee, pays. I am asking them to put in what they need to, to observe the law." Calderon acknowledged that many businesses are doing other things to help society, but this should not be done at the expense of paying taxes. "It is okay for them to have philanthropic activities, sponsor sports and cultural events, and donate medical equipment, but they need to pay [taxes] too," Calderon said.

Several business organizations took issue with the president's comments, with the Consejo Coordinador Empresarial (CCE) pointing out that federal-government expenditures have grown 80% since the election of PAN President [Vicente Fox] in 2000. Calderon succeeded Fox in 2006. The Centro de Estudios Economicos del Sector Privado (CEESP) suggested that businesses are already taxed too much, which has led to an increase in tax evasion and the growth of the informal economy. "Businesses and people not only pay too much in taxes but also have to wrestle with a complex paperwork system," the CEESP said in a study released in October. Furthermore, the CCE and other organizations warned that the new taxes would hinder Mexico's efforts to recover from the current

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economic crisis. "This is the worst moment to require an increase in taxes from business," said CCE president Armando Paredes, who raised concerns about the impact on employment, investment, and overall growth. Others agreed with this assessment. "The increase in the IVA is going to reduce sales, hurt the retailers and other businesses, and cause unemployment," said Rodrigo Sandoval, who writes the Portal Ciudadano column in the Mexico City daily newspaper Reforma. "The increase in the ISR is going to take away money that we would have used for investments, purchases, and business operations." But Rodriguez put the blame primarily on the PRI, suggesting that Calderon's original 2% tax would have spread the responsibility more evenly. "No one likes taxes, but it is worse when they lack equity, are unjust, and do not promote development," said the columnist.

Ironically, the business sector's opposition to the new taxes put it on the same side as the center-left political parties, which voted against the package. PRD president Jesus Ortega accused both the PRI and the PAN of betraying the citizens by approving tax increases that were geared primarily toward lower and middle classes. "The Congress cannot continue to play with money that belongs to the citizens," said PRD president Jesus Ortega. But that's where the similarities end. Some solutions that the PRD and its allies the Partido del Trabajo and the Partido Convergencia por la Democracia (PCD) were proposing would have directly affected the business sector. For example, PRD Deputy Alejandro Encinas said the PRD was pushing to close tax loopholes and increase taxes on transactions in the Bolsa Mexicana de Valores (BMV), Mexico's stock exchange. The center-left parties were also seeking a higher price for the estimated oil price and a higher debt ceiling. Because of their relatively small numbers in both chambers, the center-left parties had very little impact on the final version of the revenues budget.

Administration denies that taxes would limit growth

Although the Calderon administration was unable to sell its original tax plan, it is common knowledge that the president worked closely with a group of PRI insiders to come up with the compromise. Because of this, Finance Secretary Agustin Carstens took great pains to defend the proposal that came out of the Chamber of Deputies. "Those who consider this proposal recessive are mistaken," said the finance secretary. "It is designed to promote growth and allow us to compete at the international level." Before the revenues budget was approved, bond-rating agencies warned they would downgrade Mexico's debt unless it took concrete steps to shore up the sustainability of public finances. Even with the new revenues budget, there is no guarantee that the debt rating will be improved. Both Standard & Poor's and Fitch Ratings have given Mexico a BBB+ rating, the third-lowest investment-grade rating. The rating is based primarily on concern about Mexico's oil production and exports, which could have an impact on the budget. The major rating agencies are reserving judgment on Mexico's debt rating until they have had a chance to examine the budget.

A primary concern is that the budget plan does little to reduce Mexico's dependence on petroleum exports to fund its budget. "It's definitely a second-best solution," Edwin Gutierrez, who manages about US$5 billion of emerging-market assets at Aberdeen Asset Management in London, told Bloomberg news service. "It does little to reduce Mexico's structural dependence on oil for its revenue, which is what the ratings agencies wanted to see." There is also concern that the congressional plan does not create sufficient revenues to make a huge difference. "There are no

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structural changes, and public revenues remain weak," said Luis Flores, an economist at Ixe Grupo Financiero.

Some observers suggested the PRI should have used its large majority in the Chamber of Deputies to push through a more comprehensive solution to Mexico's revenue problems. "If PRI members had decided to act responsibly, they would have presented a proposal to promote deep changes in the tax code and not this band-aid that will only help in 2010," wrote Leo Zuckerman in the Mexico City daily newspaper Excelsior. Still, comprehensive tax reform is very much on the minds of some PRI officials. Speaking at an economic conference in Madrid, Spain, PRI president Beatriz Paredes acknowledged that the plan that came out of Congress "did not satisfy anyone." She said that Mexico is very much in need of a tax-policy and an economic-strategy overhaul. Some observers said the debate on the revenues budget, which exposed divisions among the parties, and an "incomprehensible" confrontation between Calderon and the private sector, created a lot of confusion. "The large number of contradictions that we experienced in the past few days, even among members of the same party, or between the administration and the parties, left us wondering who was proposing what," said Excelsior columnist Jorge Fernandez Menendez.

With the revenues budget approved, the two legislative chambers still have to consider the expenditures budget (Presupuesto de Egresos) for 2010, which by law must be approved before Nov. 15. Interior Secretary Fernandez Gomez Mont said that, despite the animosity during the revenues-budget debate, the parties were still able to agree on a plan that was ultimately approved. "Political compromise is the basis for governability in Mexico," said Gomez Mont. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Nov. 4, 2009, reported at 13.30 pesos per US$1.00]

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