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President Enrique Peña Nieto Unveils Tax-Reform Plan

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President Enrique Peña Nieto has set in motion the debate on tax reform, even though other important legislative initiatives are still pending, including the all-important energy-reform package (SourceMex, July 31, 2013, and Aug. 28, 2013). The Mexican president unveiled his tax-reform plan on Sept. 8, which aims to increase tax revenues by about 1.4% of GDP in 2013 and by 2.9% by 2018. The proposal would raise certain taxes on the wealthy and close tax loopholes while boosting the country’s growth rate.

Proposal avoids value-added tax on food, medicines

Peña Nieto’s plan avoids imposing a value-added tax (impuesto al valor agregado, IVA) on food and medicines, which might have won him support from the center-left Partido de la Revolución Democrática (PRD). In March, the governing Partido Revolucionario Institucional (PRI) left open the possibility of accepting an IVA on food and medicines (SourceMex, March 13, 2013). PRD president Jesús Zambrano, who described the president’s tax proposal as an endorsement of the principles supported by his party, said the absence of IVA on food and medicines was only one victory. He noted that Peña Nieto’s blueprint also provides for creating a strong pension plan for retirees, unemployment insurance, and eliminating some loopholes that allow corporations to evade taxes.

Some analysts suggest there might be a pragmatic reason for the president to avoid imposing a tax on food and medicines. "The government is reacting to the current economic conditions in Mexico, and this is why probably they declined to go with an IVA on foods and medicines," economist Alonso Cervera of Credit Suisse Group AG told Bloomberg news service.

An IVA on food and medicines would be very unpopular, another reason not to include this tax in the package of reforms. "The government’s decision to withdraw its proposal to apply an IVA to medicines and food ... should not be seen as an act of generosity or sensibility," columnist Raúl Correa wrote in a guest piece for the online news site La Otra Opinión.

Correa noted that the effort to apply an IVA to food and medicines dates back to the administration of ex-President Carlos Salinas de Gortari, and successive governments have tried to convince the public to "swallow this bitter pill" with no success. "Time after time, it has been rejected," said the columnist.

The president did make one notable exception regarding a tax on food. His plan contains a tax of 1 peso (US$0.08) per liter on soft drinks, which he said is an effort to help improve the health of Mexican citizens. The proposal calls for the tax on "flavored beverages as well as concentrates, powders, syrups, essences, or flavor extracts." The levy is expected boost the price of soft drinks and sugar-based beverages by 15% to 20%.

Public-health advocates agreed that the tax is a step in the right direction but insufficient to reduce Mexico’s high sugar consumption. "It’s good that such a tax has been proposed. We have to acknowledge that," said Alejandro Calvillo, head of the Mexico affiliate of the international
consumer watchdog group Consumer Power. "But to have a significant impact on consumption of sugary drinks, assessments show that it should be a 20% tax."

**PAN opposes some measures**

While the tax plan generally appears to meet the approval of the PRD leadership, there is less enthusiasm from the center-right Partido Acción Nacional (PAN), which has come out against some elements of the proposal, including an IVA on private-school tuition and a tax on mortgages. The PAN and some members of the PRD are concerned that these measures could harm the middle class.

"This initiative prevents families from improving their living conditions," said PAN Sen. Ernesto Cordero, who served as finance secretary under former President Felipe Calderón. "An IVA on the sale and rental of homes will increase monthly payments on mortgage payments. Therefore, this plan presents an obstacle for many to obtain a dignified home."

Some PRD legislators, including the party’s Senate floor leader Miguel Barbosa Huerta, have joined the PAN in opposing higher taxes on private-school tuition. While the rich could absorb this tax, the new levy could create hardships for an important segment of middle-income Mexicans in sending their children to private schools.

The PAN also raised objections to Peña Nieto’s plan to standardize IVA rates across the country, bringing the states along the US-Mexico border in line with the rest of the country. At present, border states pay an 11% IVA, while in other states it is 16%. PAN legislators are concerned that businesses in border communities would not be able to compete with their counterparts in the US, where sales taxes range between 5.1% and 7.5%.

"I feel we have to form a bloc with all those legislators who don't want [tax reforms] to negatively affect the majority of the population, whether they’re from the PRD or the PRI," said Sen. Jorge Luis Preciado, a floor leader for the PAN in the upper house.

"If we can think of ourselves as an opposition bloc, this will allow us to conduct a comprehensive review of the tax-reform proposal," Barbosa Huerta said.

Still, the Peña Nieto government and members of the PRI have said they are willing to consider these concerns during committee and full debates in the coming congressional session. The three major parties committed to work together to advance important issues when they signed Pacto por México with the president in December 2012 (SourceMex, Dec. 5, 2012, and Jan. 9, 2013), which improves the chances for compromise.

**New taxes on wealthier Mexicans**

The president’s target of boosting revenues in coming years also depends largely on increased taxes for wealthier Mexicans. One measure that could have broad agreement among the three parties is the decision to impose a 10% tax on gains of capital assets transactions, including stock sales and dividends. "This reform will close a glaring loophole that primarily benefited the wealthiest of Mexicans," James Jones, co-chair of Manatt Jones Global Strategies, said in an interview with the Inter-American Dialogue’s Latin America Advisor.

Additionally, the plan would increase the personal income tax rate to 32% from the current 30% for taxpayers who earn more than 500,000 pesos (US$39,500) per year.
The proposal also includes a handful of revenue measures, including reducing gasoline subsidies, adding new taxes on radio-spectrum use, and reformulating fees for mineral rights.

The Peña Nieto government insists that its tax-reform plan, which would boost revenues by about 240 billion pesos (US$19 billion) in 2014, is needed to promote economic growth and allow Mexico to boost its public expenditures significantly. "Our economy has not reached its potential growth rate in the last 30 years," said a document submitted by Finance Secretary Luis Videgaray. "During this period, GDP growth has averaged 2% in real terms."

"Public spending as a percentage of GDP in Mexico has amounted to only 19.5%, while the average in the rest of Latin America is 27.1%, and 46.5% in the member countries of the [Organization for Economic Cooperation and Development]," said the administration. "Poor growth has not allowed us to satisfy the most basic social needs of large segments of the Mexican population, and that is why 45.5% of our population suffers from poverty."

Two significant proposals in the tax-reform plans involve changes to the Constitution that would create a universal pension system for retirees and unemployment insurance for all workers in the formal economy. For the pension, the president proposed that all eligible retirees receive a monthly pension of 1,200 pesos (US$95) in 2014. The unemployment-insurance scheme would be funded by levying a special tax on employers.

Some analysts suggest that these proposals, while a step in the right direction, amount to token actions. "I would have liked for the government to have also announced concrete measures to boost the minimum wage, as required by the Constitution," José Luís Hernández Jiménez wrote in La Otra Opinión. "At present, the minimum wage is barely sufficient to allow people to eat."

Hernández Jiménez said the government should also decree a 40-hour workweek to combat unemployment and reduce the number of people who have to resort to the informal economy.

Will increased taxes make up for loss in PEMEX revenues?

The Peña Nieto plan also assumes that Congress will soon approve reforms to the energy sector, and one proposal that has received support across the board is allowing the state-run oil company PEMEX to keep a much larger share of its revenues instead of paying "taxes" to the Mexican treasury. This potential reduction in income from PEMEX activities makes it even more imperative that the government find new sources of revenues.

Along with his tax-reform plan, the president submitted to Congress his 2014 expenditures budget, which allows for a deficit of 1.5% of GDP. That ratio would climb to 3.5% of GDP when a proposed US$27 billion in PEMEX investment is included.

Despite the administration’s optimism, some analysts say the revenue measures contained in Peña Nieto’s tax proposals might not be sufficient to compensate for the loss of income that would have been obtained from PEMEX activities.

"To break the dependence on oil, to increase revenues, and to have an efficient tax system, the country needs a profound fiscal reform that modifies the structure of revenues and expenditure," Alfredo Coutiño, director for Latin America at Moody's Analytics, said in an interview in the Latin America Advisor. "Unfortunately, the fiscal proposal already in Congress does not seem to produce the kind of structural changes that the country needs, particularly because it is mainly focused
on the income side through increases in tax rates, new taxes, and reduction of exemptions and privileges. The structure of the tax system will mainly stay the same with the new reform." [Peso-dollar conversions in this article are based on the Interbank rate in effect on Sept. 18, 2013, reported at 12.65 pesos per US$1.00.]

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