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Chamber of Deputies Easily Approves President Enrique Peña Nieto’s Tax-Reform Package

by Carlos Navarro
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While the Mexican Congress debates the merits of tax reform, a discussion is also underway on whether the country is in the midst of an economic recession. Mexico’s GDP is expected to grow only about 1% in 2013, a stark contrast to earlier estimates that projected an expansion of close to 4% for the year. As has been the case, Mexico’s economic fortunes have been connected to those in the US, and the uncertainty created by recent developments in the US Congress—including the recent two-week shutdown of government operations—has had a direct impact on Mexico.

On Oct. 20, the Chamber of Deputies approved a tax-reform plan that includes most of the controversial provisions that President Enrique Peña Nieto proposed. The governing Partido Revolucionario Institucional (PRI) was able to convince a majority of the legislators from the center-left Partido de la Revolución Democrática (PRD) to support the president’s plan, with the measure passing by a 293-177 vote.

The measure included a 10% tax on capital gains, applying the national value-added tax (impuesto al valor agregado, IVA) to the border states, and imposing a 5% tax on junk food and soft drinks (SourceMex, Sept. 18, 2013). The reforms would increase personal income taxes for the wealthiest Mexicans to between 31% and 35%, depending on total earnings.

The Peña Nieto government said the few changes approved in the lower house did not detract from the original intent of the proposal, which was to boost revenues while not directly affecting the finances of most Mexican families. In a statement, the Secretaría de Hacienda y Crédito Público (SHCP) said the modified bill resulted in some reduction of revenue, but the changes were “realistic” and "objective," and the decision was the result of a "responsible collaboration."

Legislators removed a controversial tax on private schools and real estate transactions, but this was not enough to appease deputies from the pro-business Partido Acción Nacional (PAN), which voted overwhelmingly against the measure.

**Tax-reform passage less certain in Senate**

The level of collaboration might not be as strong in the Senate, where the PAN appears to have convinced the PRD to join in opposing the measure if the charge of a 16% tax on the states that border the US is not rescinded.

"Perhaps we can avoid the same mistake in the Senate," said PAN floor leader Sen. Jorge Preciado, in reference to the alliance between the PRI and the PRD in the tax-reform vote in the Chamber of Deputies.

PAN senators also oppose other taxes in the plan approved in the Chamber of Deputies, including levies on imports, fuel, and transportation. "There will be a major battle in the Senate … to try to prevent these taxes from passing," said Preciado.
Preciado said some PRI senators might also be convinced to support changes in the tax-reform bill that would eliminate the increase in IVA. "We are going to meet with those senators who represent the border states, with the senators who represent agricultural producers, and with those associated with the Consejo Nacional Agropecuario," said the PAN senator. "We want to ask them to help us find a way to keep these taxes from passing."

Sen. Miguel Barbosa, floor leader of the PRD in the upper house, also offered strong support for maintaining the IVA at current levels in border states, since this could affect many low-income residents whose livelihoods depend on local retail sales. An increase in IVA could prompt Mexican consumers to turn to US products, which would be cheaper. "We must maintain solidarity with those who have the least and defeat the changes in the IVA that would boost the rate from 11% to 16%," said Barbosa.

The Asociación de Maquiladoras de Ciudad Juárez (AMAC) said maquiladora plants in the city laid off 490 workers and canceled plans to hire 5,000 employees in September because of looming tax reforms.

Still, Preciado acknowledged that the PAN and PRD could be fighting an uphill battle, especially if PRI senators cannot be convinced to vote against the position of their party. At present, the PRÍ and its partners, the Partido Verde Ecologista de México (PVEM) and Partido Nueva Alianza (PANAL), have 61 votes, just short of the majority needed to approve the tax-reform version passed in the Chamber of Deputies.

"If they are able to pick up another four votes, the party is over," said Preciado, pointing to the votes from the Partido del Trabajo (PT) and Movimiento Ciudadano (MC). If the smaller center-left parties are convinced to vote the other way, it could tip the final vote to the PAN-PRD coalition.

**Implications for 2014 Budget**

Along with the tax reform, the Senate has to ratify the revenues budget (Ley de Ingresos) approved by the Chamber of Deputies for 2014. The measure—approved by an overwhelming margin of 387-52 with 30 abstentions—resulted in a revenues budget of slightly more than 4.4 trillion pesos (US$338 billion), compared with 3.9 trillion pesos (US$300 billion) approved for the 2013 budget (SourceMex, Jan. 9, 2013). The total for 2014 includes 2.7 trillion pesos (US$207 billion) in revenues obtained by the federal government, which would take into account the increased taxes collected under the tax-reform law. In 2012, the earnings of the federal government were set at 2.4 trillion pesos (US$185 billion).

The government said the changes made in the Chamber of Deputies to the original tax-reform proposal would reduce projected revenue gains by 55 billion pesos (US$4.2 billion). The deputies compensated for that shortfall by voting to raise the oil-price forecast in the revenues budget from US$81 a barrel to US$85 a barrel and by increasing the expected exchange rate to 12.9 pesos per US$1.00 from the previous forecast of 12.6 per US$1.00.

An analysis in the Mexico City daily newspaper Excélsior noted that the state-run oil company PEMEX would remain a major source of financing for the federal treasury. For example, the government is projected to obtain about 785 billion pesos (US$60 billion) in fees related to energy rights and about 16 billion pesos (US$1.2 billion) in fuel taxes.
**Budget assumes moderate economic recovery in 2014**

The Chamber of Deputies maintained the forecast for GDP growth at 3.9% for 2014. This assumes that the economy will recover significantly next year from the slump experienced in much of 2013.

Some observers point out that Mexico’s economy would be considered in a recession if the classic definition were taken into account: two consecutive quarters of negative growth. "The economic stagnation has been so dramatic that many experts suggest that Mexico’s economy is in the midst of a recession," columnist Leo Zuckermann wrote in Excélsior.

The government’s statistics office Instituto Nacional de Estadística y Geografía (INEGI) said there was zero growth in the first quarter of 2013 and a contraction of 0.74% in the second quarter.

Economist Gerardo Esquivel of the Colegio de Mexico said there are other signs that Mexico is in a recession, especially since economic activity has not recovered on a consistent basis after the country attained its point of maximum growth in 2012. "Because of this, it is possible to conclude that Mexico, unfortunately, is facing another economic recession," said Esquivel. "This recession likely started between July and November 2012."

Esquivel noted that this recession would be the third in the 21st century and the seventh in the last 30 years.

Respected economist Jonathan Heath, who is affiliated with the Instituto Mexicano de Ejecutivos de Finanzas (IMEF), reached similar conclusions. "In the middle of last year, Mexico’s economy entered a period of apathy, characterized by very weak economic activity," said Heath. "By the beginning of 2013, the economy stopped growing, and we entered a period of generalized stagnation."

Heath pointed out, however, that the current recession does not seem to be very deep, which could usher a faster recovery.

The Peña Nieto administration will not acknowledge that Mexico has suffered a recession. Finance Secretary Luis Videgaray told reporters that "looking at the technical definition, Mexico has not suffered a recession." Still, Videgaray admitted that Mexico has recently experienced "a moment of weakness in its economic growth, linked to a downturn in the US."

Agustín Carstens, chief governor at the Banco de México (central bank), had a similar interpretation. "We are facing an important deceleration," said Carstens. "But we need more information to determine whether we are in a recession."

The uncertainties that have driven the US economy—including the budget battle in the US Congress that resulted in a partial two-week shutdown of the US government—have had a direct impact on Mexico. At the start of the shutdown in early October, the Mexican peso fell to the weakest level in one month because of concern that a slowdown would reduce demand in the US for imports of Mexican products.

There was particular concern along the US-Mexico border, where the maquiladora industry—already under threat of an increase in costs from the higher IVA approved by the Chamber of Deputies—would suffer significant losses because of the nature of the industry, which delivers products on a demand basis.
"A reduction in the US economy will have a negative effect on the demand for goods and services, not only in the maquiladora industry but in the US economy in general," said Raúl Alberto Ponce Rodríguez, an economist at the Universidad Autónoma de Ciudad Juárez. [Peso-dollar conversions in this article are based on the Interbank rate in effect on Oct. 23, 2013, reported at 12.99 pesos per US$1.00.]

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