

Fiscal Reform in Mexico Postponed Again

Pablo Ruiz Nápoles*



Pablo Zamora/Cuartoscuro



Sandra Perdomo/Cuartoscuro

Elba Esther Gordillo (left) and Emilio Chuayffet (far right) headed up the two factions of the PRI caucus, divided because of diverging positions on the fiscal reform.

Congress passed Mexico's 2004 budget after a long confrontation between the executive and the legislature and between two factions of the Institutional Revolution-

ary Party (PRI) caucus, the largest caucus in the Chamber of Deputies.¹ The final result was an agreement negotiated inside the opposition that really satisfied no one and did not resolve the central problem of low tax revenues. As a result, we again face the

prospect of low revenues for the state. This demonstrated that the federal government is incapable of getting bills through Congress, in this case that of the fiscal reform. This is nothing new for the current administration: since the bill to build a new airport for the

* Economic and political analyst.

nation's capital failed, practically all of its bills have been rejected by the population in general or by specific interest groups. The government has not been able to politically overcome this lack of acceptance.

The tax bill was particularly important because, halfway through its term, of the four substantive reforms the executive has proposed (the fiscal system, energy production, labor rights and the reform of the state in general), this was the only truly strategic one; for some analysts, it was also the one with the greatest chances of success. After this failure, it will be very difficult for the administration to implement reforms or changes that pay off in real, credible

revenues, particularly after the bank bail-out in the mid-1990s that increased real public debt and requires high interest payments every year. The attempts to broaden the tax base and, above all, check tax evasion by high-income groups and the informal sector have failed. As a result, most of the tax burden falls on the shoulders of the middle class, captive in the tax system, whose upper strata pay developed-country tax rates while receiving in exchange the services of an underdeveloped country. Another large taxpayer in the Mexican system is Pemex, the state oil company, which transfers a significant part of its income through tax monies to the state. Partially because of that, it stopped investing

my and cover educational and health needs without creating a public deficit. The Fox administration has not been able to achieve this because the party that supports it, the PAN, has not had the majority in Congress as the PRI almost always had when it was in office. This new political situation is behind the need for lobbying, negotiation and agreements, that neither the president nor his cabinet have been able to get either from the opposition parties or from the real power groups like unions, chambers of commerce and peasant organizations. The president has only been interested in the media, which today wields important political clout, but first and foremost vis-à-vis his image.

The fiscal reform was also badly formulated from the start. It concentrated on proposing that the value added tax (VAT) be applied to foodstuffs and medicine, which had never been taxed by previous administrations. This caused an immediate drop in the president's popularity and made a gift of these issues to the opposition. The proposal to reduce income and corporate tax was also dimly viewed because no one ever explained that this actually meant higher revenues since it would tend to decrease tax evasion. But perhaps the proposal's worst mistake was that the 2004 budget for programmed public spending was based on the idea that there would be no change in revenues with regard to the previous year, and was structured in such a way as to increase funding for socially unimportant items and de-fund sensitive items like higher education, science and technology. In addition, the president's package proposed the sale of certain state scientific research, higher education and cultural institutions, incurring the wrath of groups

Attempts to broaden the tax base and check tax evasion by high-income groups and the informal sector failed. Thus, most of the burden falls on the middle class.

economic and political terms over the next three years so that the National Action Party (PAN) can be reelected in 2006.

THE NEED FOR FISCAL REFORM

For quite a while, Mexico has been a tax haven for some of its inhabitants compared to other countries—both developed and developing—of similar size. Total state revenues as a percentage of gross domestic product (GDP) are barely one-fourth of those in places like Scandinavia. The reduction of the state apparatus as a result of the sale of its companies and the closing of public institutions since the mid-1980s has not lessened the need for public

in its own modernization years ago, enormously complicating the possibility of increasing its productive and refining capabilities, its productivity and even putting at risk its very existence as a state company.

WHY THE ORIGINAL PRESIDENTIAL BILL FAILED

All of this is behind the current administration's proposing up front a fiscal reform that would allow it to increase tax earnings, make tax collection more democratic by eliminating privileges and reduce the middle class's tax burden. At the same time, it would create additional resources that, if appropriately channeled, could stimulate the econo-

of scientists and intellectuals. All this was clearly a negotiating strategy aimed at getting Congress to approve the bulk of the fiscal reform, but without having a back-up plan in case the executive's proposal was rejected, which it was.

THE DEBATE AND APPROVAL OF THE 2004 BUDGET

The president's bill differed very little from those of previous years. What was new was the administration's attempt to get a majority vote in Congress by allying itself with a sector of the PRI whose influence was thought to be decisive.

With this budget we cannot expect
that 2004 growth objectives will be achieved,
even though they are limited.

Elba Esther Gordillo, then the PRI caucus leader in the Chamber of Deputies —today she has been replaced— amended the bill and managed to get it through the Chamber's Finance Commission.² The unexpected obstacle on the road to approval was the president of the PRI himself, Roberto Madrazo, who, after having praised the proposal, reversed his position, dividing the PRI caucus in two and coming to an agreement with other parties to defeat the bill in the final vote. The central objection to the bill amended by his own party, the PRI, was a tax on producers and intermediaries of food and medicine, which supposedly was not to be passed along to the consumer. This tax, the mechanisms of which were never convincingly explained, was understood

as a disguised VAT, and the bill was defeated by a small margin of votes.

The political dispute between the president and Congress, on the one hand, and inside the PRI, on the other, continued and the PAN presented a similar bill which was defeated in the commission. The opposition proposed a miscellaneous tax bill, differing little from the one passed for 2003, but with a few changes in the structure of public spending.³

PROSPECTS

In summary, there was no fiscal reform and budgetary changes in spending

tration to try for the other three reforms with any chance of success. Therefore, it is very probable that in the next three years, none of President Fox's campaign promises will be kept. Even if he had been able to pass all the reforms, he probably would not have been able to completely implement his political and economic project, a project which was never really fully explained to the public.

In any case, this failure, together with the previous ones, creates a very difficult political panorama for the president's party vis-à-vis the 2006 federal elections. This scenario will facilitate either the return of the PRI or the PRD being elected. To avoid that defeat, some political analysts think the president has to reshuffle his cabinet this year, particularly with regard to those responsible for seeking political agreements, which seems to have been one of the weakest areas.⁴ ■■■

NOTE

¹ Mexico's annual budget is actually made up of two separate documents, the Expenditures Budget and the Federal Revenue Law. [Editor's Note.]

² Gordillo was one of the most influential and controversial figures in the PRI, particularly during the Salinas administration, when she was the general secretary of the powerful National Educational Workers Union. [Editor's Note.]

³ A miscellaneous tax bill is one which proposes a few changes that do not affect the broad structure of the tax system. [Editor's Note.]

⁴ The author is referring here to the Ministry of the Interior, headed up by Santiago Creel Miranda, one of the presidential hopefuls. [Editor's Note.]