

A much-needed fiscal reform

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The difficulty in collecting taxes is one of the biggest challenges the Fox government will face in order to invest in the public goods that can consolidate the economic reforms of the last decades.

For a variety of historical and structural reasons, the Mexican state has been particularly ineffective in collecting taxes. The government's ability to collect taxes is one of the lowest in Latin America. In spite of several tax reforms that have taken place over the last 20 years, government tax revenue has not increased and has remained dependent on oil. Thanks only to the containment of public expenses since the debt crisis of 1982 has Mexico managed to avoid the hyperinflation experienced by other countries in the region. This avoidance has occurred, however, only at a very high cost in terms of the capacity of the state to tackle poverty and invest in much-needed public goods.

The difficulty in collecting taxes is one of the biggest challenges the Fox government will face in order to invest in the public goods that can consolidate the economic reforms of the last decades. More revenues are also needed to make democracy something more than the mere act of electing a government. For decades, Mexico was governed based on exclusions. The new administration needs to give each Mexican a minimum set of political and social rights.

BROADENING THE TAX BASE

Sound public finances are needed for macroeconomic stability. However, if sound public finances are arrived at only through sacrificing expenses, public goods and citizen rights will be left wanting. According to the OECD, Mexico needs to spend more to provide better quality education, health, and infrastructure as well as to fight against poverty. Additional public resources can be generated only through an increase in tax income.

Historically, democracy has implied that voters demand better and more reliable public services and a wider set of effective rights. Democracy must transform clients into citizens with rights. These

rights can be financed only with taxes. If democracy doesn't have the capacity to respond to the voters' needs, then its consolidation will be more difficult.

Capitalism has implied, as a result of creating and distributing wealth from private initiative and decentralized institutions such as the market, an unequal distribution of property. Democracy, based on the principle of equality of opportunities—"one individual, one vote"—can confront these disparities through a fiscal policy agreed upon by representatives elected by all adult citizens.

Mexico's low fiscal capacity has historically led to one of three scenarios. First, the critical situation that occurred in the first half of the 19th century, when not even the army could be financed, leading to innumerable rebellions.

Second, high public deficits have resulted from confronting increased social demands, without paying the political cost of higher tax revenue. This was the case during the tenures of Echeverría and López Portillo, when new public debt and oil revenue allowed high public expenditure for 12 years, until the 1982 crisis forced the government to make a severe adjustment.

Third, we have those periods when income is enough to allow governability, but low revenues imply that balanced public finances are achieved as the result of very low public expenditure. An extreme example of this took place during the long stability of the Porfirio Díaz government, in the last decades of the 19th century, but this stability was achieved thanks to the provision of only some basic public goods and virtually no social expenditure. By 1910, 70.2 percent of Mexicans were illiterate. A less extreme case, but equally politically unsustainable, has taken place since the 1982 crisis. Relatively balanced public finances have been achieved only thanks to the lack of public expenditure in critical public goods and social investment. Governments have been aware of the need for a significant increase in tax revenue, but have lacked the political and administrative strength to conduct a fiscal reform that increases revenue in a significant and sustainable way.

TAX REFORM: WHO HAS THE MONEY?

This recurrent failure is the result of the political logic of the Priista regime, which was based on conceding privileges to key sectors. Tax exemptions have been concentrated in those groups that were politically more important. A regime based on the politicization of the administration cannot construct an effective tax administration. A very low legitimacy,

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These instances reveal that a level playing field is far from being attained. This is not because Canada and Mexico are not as market-oriented as the United States wishes they were, but because the United States remains the most protectionist party of the three countries.

After years of U.S.-led free trade diplomacy, Canada and Mexico are still learning to cope on two fronts opened by this venture. NAFTA not only promotes U.S. foreign trade interests abroad, it also attempts to work as an institutional constraint to deter protectionist pressures at home. The first goal has been successful so far, as witnessed not by trade performance but by the institutional changes it has provoked in Cana-

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da's and Mexico's economic organization. As for the second goal, NAFTA is still far from levelling the playing field among its partners, this time vis-à-vis U.S. practices.

To be sure, U.S. protectionism has become more manageable under NAFTA, but it is still far from being policed under

trilaterally agreed-upon rules. If Washington wants to make its commitments toward the principled regime it is promoting more credible, it should campaign at home and abroad for the creation of a trade tribunal ruled by common trade legislation to which the three NAFTA partners abide on an equal basis. ❖

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especially after the 1982 crisis made tax collecting more difficult.

The government of Vicente Fox is well aware of the need to raise revenues. It has the advantage of enjoying the legitimacy of having sacked the PRI in clean elections. One of its first important initiatives has been a tax reform based on eliminating most exemptions in the VAT and income tax laws, while lowering income tax rates. While technically correct, because it would create a less distorted and easier to manage tax system, such a reform is difficult to sell to the public and to Congress. Particularly as the two most visible features are taxing food and medicines, while diminishing the rate paid by the richest Mexicans from 40 to 32 percent.

Although Fox's popularity has been dented, the president seems determined to achieve tax reform. The new government, however, has exhibited its lack of experience. Before demanding higher taxes, more efficient and transparent government expenditure would have been helpful. Increasing VAT while lowering income tax for the richest at the same time made it an easy target. The president has carried most of the weight in his effort to promote the

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reform, but, in spite of his undeniable talent, he has been unable to convince society of its virtues. Moreover, the president's party does not have majority in any of the Chambers, so his popularity is not easy to transform into legislation without a careful negotiation with the PRI, an element that, so far, seems to have been absent. Fox's government has even been unable to convince his own party, the PAN, of the need to defend tax reform.

Fox had expected to have the reform approved quickly by Congress in April, before Congress was dismissed. He then thought an extra period could be agreed upon easily. However, it seems that without major changes, tax reform

will not be ready for an extra period and will have to wait until September, when Congress is obliged to meet again. Without any major change in the government's strategy and if the PRI remains united, it will be very difficult to pass Fox's reform in both chambers.

If the new government does not devise a different strategy to raise revenue, the Mexican state will continue to be unprepared to face the innumerable challenges of public safety, infrastructure, education, health, and justice. These challenges, all Mexicans agree, require strong public attention, but have not agreed upon the way to raise the much-needed public revenues to confront them. ❖