Mexico needs another tax reform

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In 2019, whoever wins the next presidential elections, a tax reform will be necessary and impossible to put off. This is basically due to the fact that, even with what was achieved by the reform of 2013, the country's level of tax revenues is very low compared with other economies. It is by far the lowest of any OECD country. Whereas Mexico's tax revenues were approximately equal to 17% of GDP in 2015, the latest year for which comparable international data are available, those of France for example were 45%, Germany 36%, the US 26%, Japan 43%, Spain 34% and the UK 33%. And Mexico not only collects less tax than the developed countries of the OECD.

It also takes in less than other countries with similar or lower levels of development; tax revenue as a percentage of GDP is less than that of Chile, Peru, Brazil, Colombia, Turkey, Ecuador, Argentina or Bolivia, to name a few examples. And we should bear in mind that the situation was even worse before the 2013 reform, when Mexico's tax revenue was around 10% of GDP.

This low tax income obviously translates into low public spending. Government spending in Mexico is also low: the lowest of any OECD country. And as in the case of revenue, spending as a percentage of GDP is less than that of several countries with similar levels of development. Government spending as a percentage of GDP is less than 30%, placing us below Brazil, Chile, Colombia, Turkey, Argentina, Bolivia, India and China.

And these low levels of spending in turn mean that not enough is invested in the items that could drive medium-term growth, such as infrastructure, healthcare and education. Of particular concern is the fact that government investment has been falling over the past nine years. The percentage of public spending earmarked for investment in 2017 will be the lowest since 2006.

For the first time the country will spend more on pensions than on investment. Less investment will mean a lower potential growth rate in the future. And with the current fiscal structure there is very little room for manoeuvre for the government to be able to invest in infrastructure, healthcare and education. 57% of the government's non-oil revenues will be used for spending items that are unavoidable: contributions to the federal states, payment of pensions and servicing the public debt. And without fundamental change, these items will continue to grow in the coming years.

For all these reasons further fiscal reform will be inescapable. From my point of view, this reform must cover the following measures, as a minimum. i. Eliminate the VAT exemption for food and medicines. VAT is a tax that is relative easy to collect, apart from the fact that the exemption is regressive, since it benefits those that consume most. The additional intake could be used to lend assistance to low income families so that they are not affected by the measure. ii. Redefine the formula for contributions to states and municipalities in such a way as to provide incentives for them to collect more taxes themselves (despite having the power to collect taxes, Mexico's states and municipalities actually collect very little). The formula should assign more resources by way of contribution to the states and municipalities that make the biggest tax collecting efforts. iii. Combat tax evasion more decisively and promote formal employment. The main factor behind the low tax take is the narrowness of the tax base due to the high level of informal employment in the economy.

A real effort must also be made towards a zero-base budget, eliminating programmes with little social impact or that do little to drive growth. For example, spending on advertising should be almost completely eliminated. Last year 8.5 billion pesos were spent on advertising. This spending neither has a social impact nor generates economic growth.

If Mexico is to attain higher growth rates, there must be a new fiscal reform that substantially increases the government's tax collection capacity so that more can be invested in physical and human capital.

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